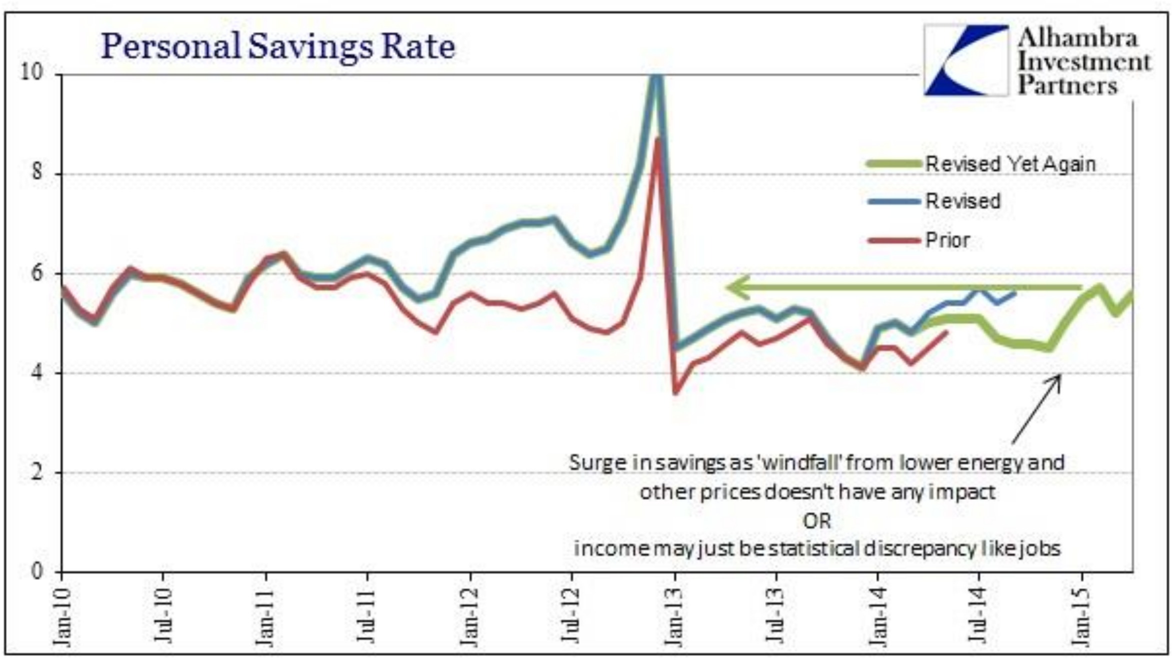
MONTHLY ECONOMIC CHART REVIEW

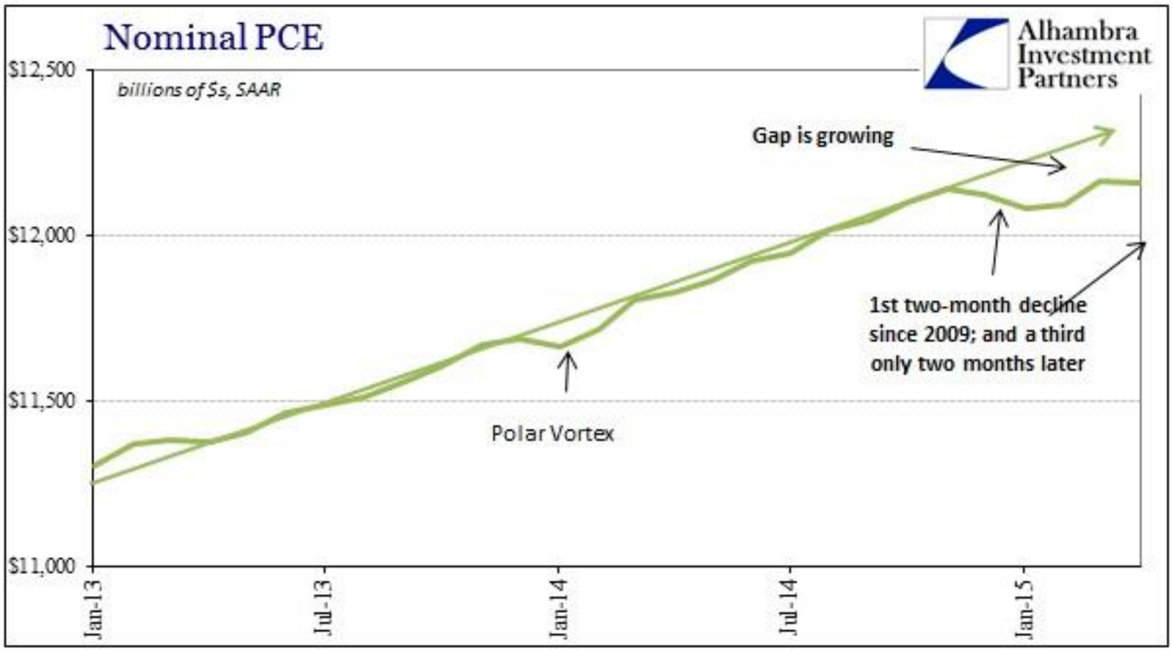
<u>THE YELLEN DOCTRINE</u>: Asset bubbles are no big deal and are actually 'necessary' given 'secular stagnation.' In other words, great financial imbalances can be beneficial ***IF***:

1. Economic growth is created from them sufficiently to retroactively justify them;
2. Financial health and 'resilience' continues to be sufficient to assure any defectors from Part 1; i.e., systemic liquidity as it relates to forestalling 'tail risks.'

PART 1: Economic Sufficiency

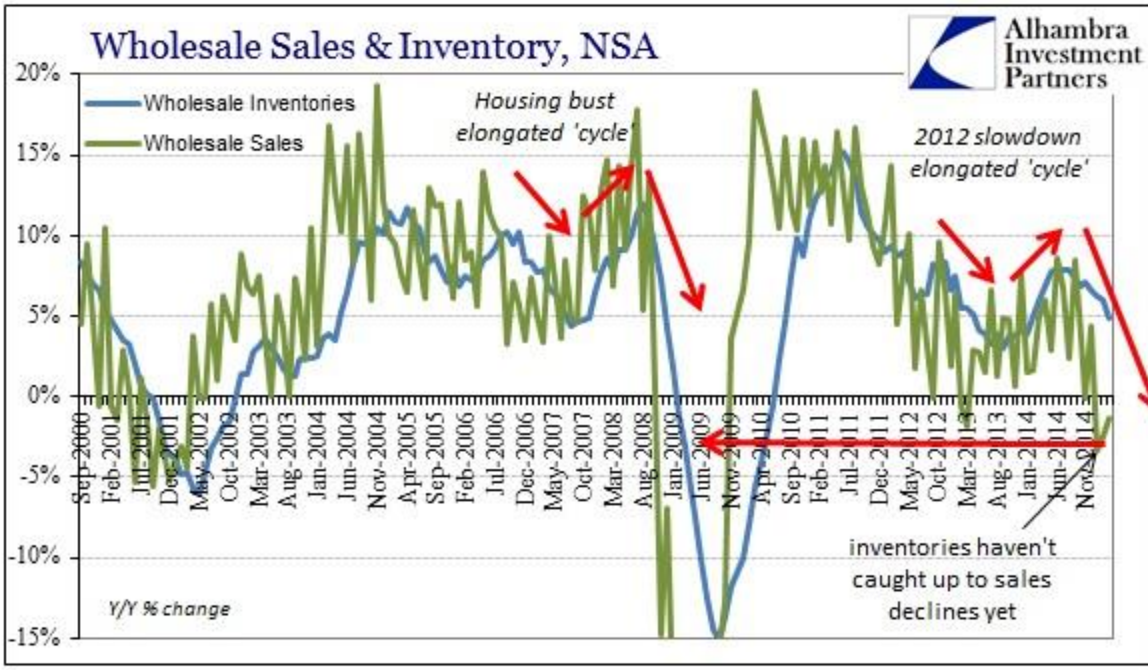


Something changed with consumer behavior starting in November (recall very weak Black Friday and Christmas sales).



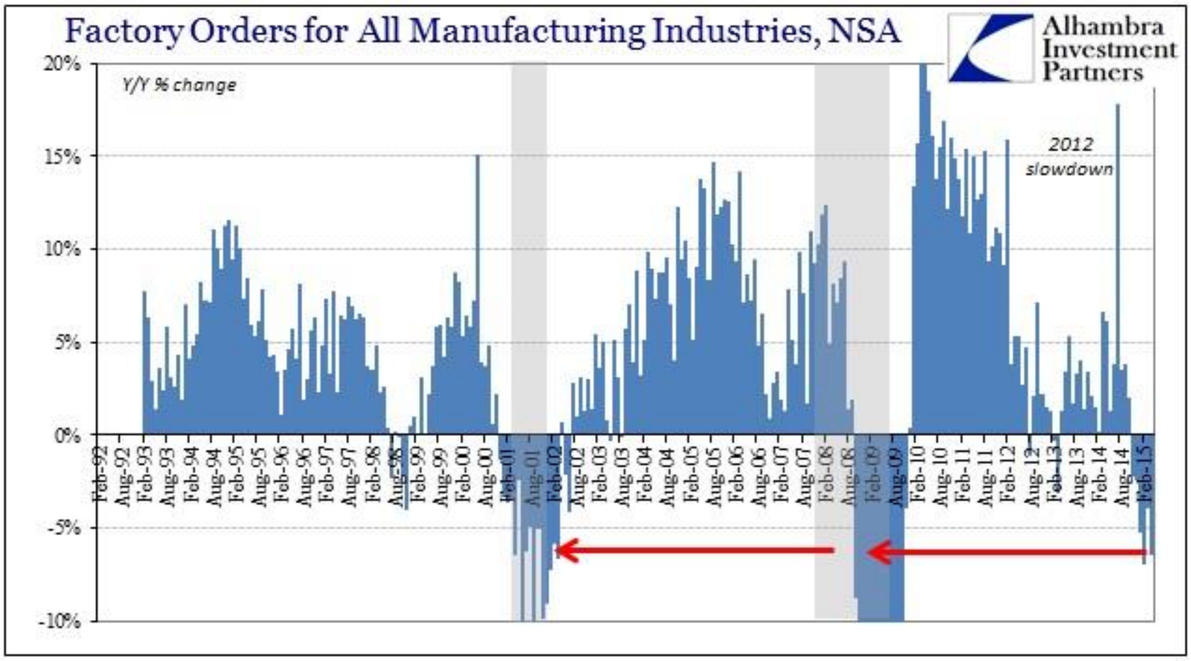
Spending started to slump without a major drop-off in household income; wages had been substandard for years, including 2014, but consumers tightened dramatically entering 2015.

As with PCE, retail sales show consumer 'shock' was broad-based and sharp.

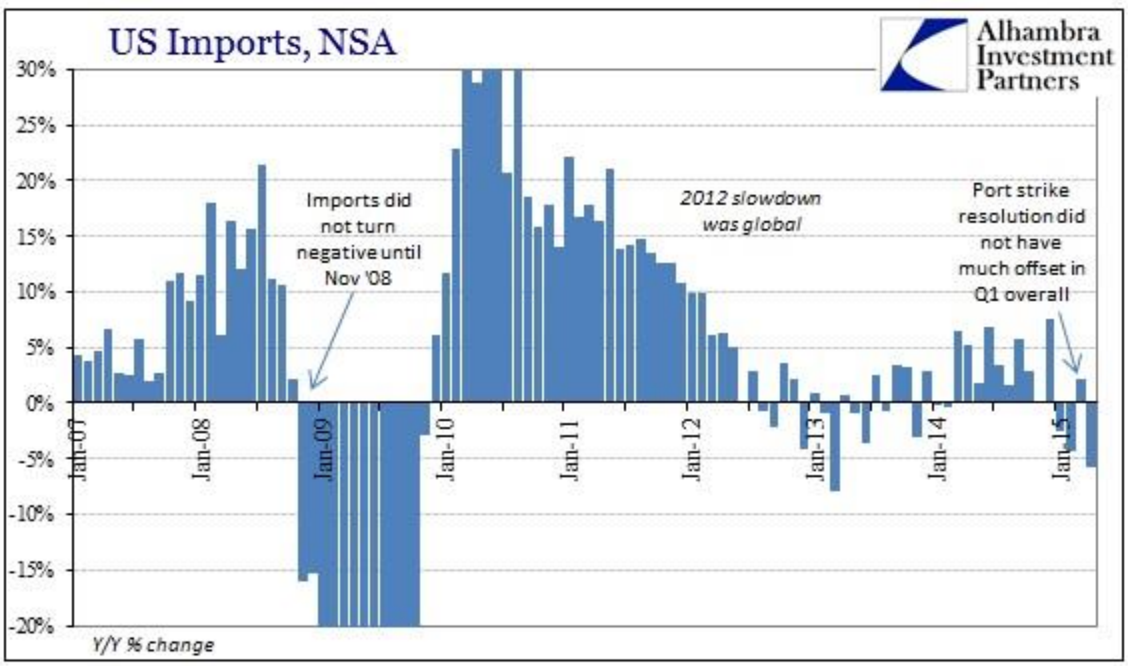


That top end weakness has moved down the supply chain, with wholesale sales falling as retailers call the halt.

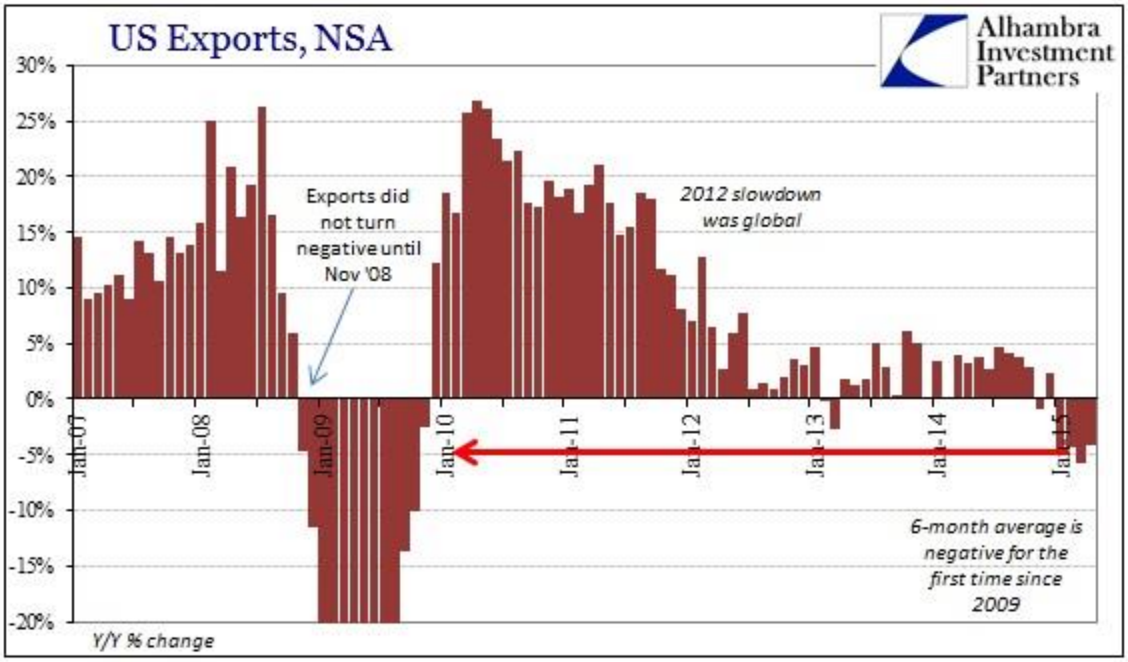
Inventories have yet to equalize with sales, leaving inventory levels at 'cycle' highs in terms of relevant metrics and even record highs in terms of what is tracked within GDP.



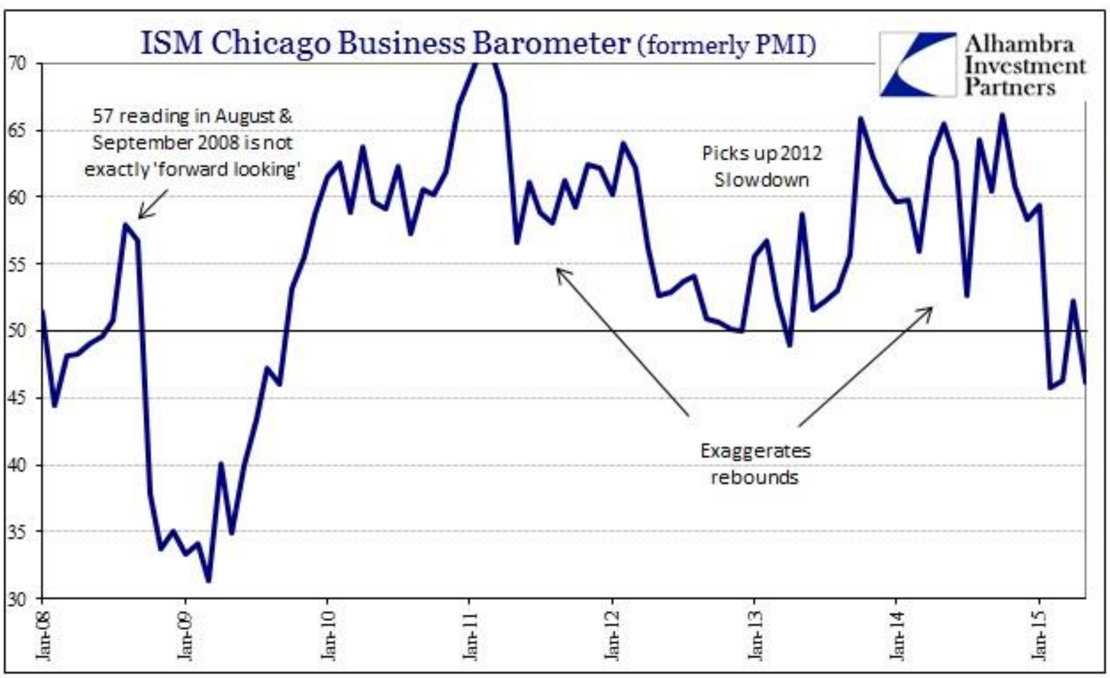
Supply chain 'recoil' has reached all the way down to production, where factory orders show wholesalers attempting to slow the inventory accumulation.



The manufacturing piece of the supply chain also extends overseas, as the import 'slump' shows that wholesale caution is widespread (and no good news for China and the rest of the global economy).



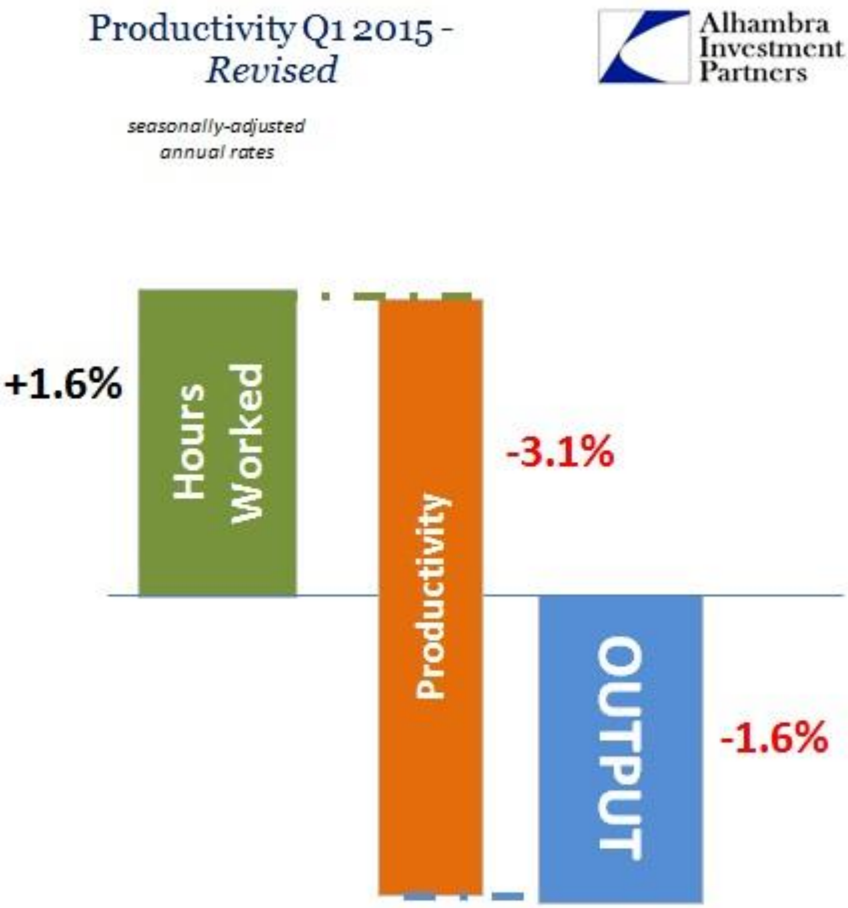
The domestic manufacturing 'slump' has lost what little export support there was prior to 2015, with exports contracting steadily this year (with the higher dollar conversion getting blamed even though contracting imports suggest economic rather than currency factors globally).



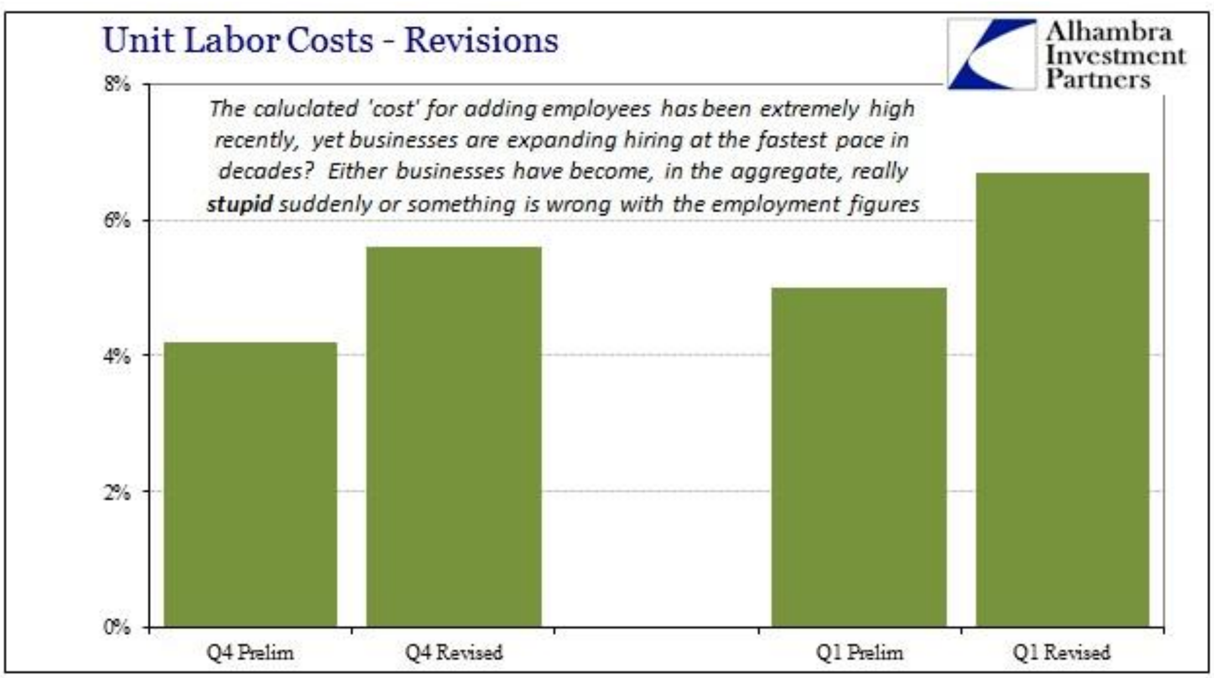
Slowdown picks up in 2015

The manufacturing hit has even extended into various PMI's and sentiment surveys, including ISM's Chicago Business Barometer and numerous Fed manufacturing surveys.

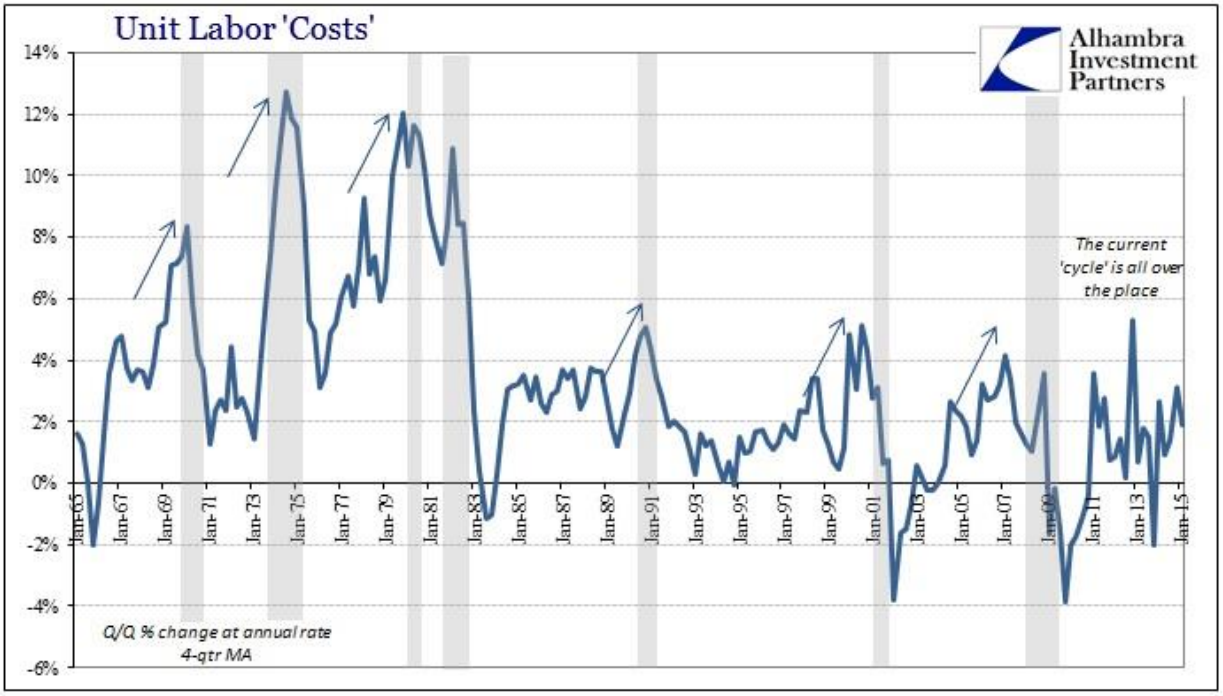
If the US economy is not heading toward recession from this data, at least from the consumer perspective, it is making a very good attempt at replicating the primary pattern of all prior outbreaks.



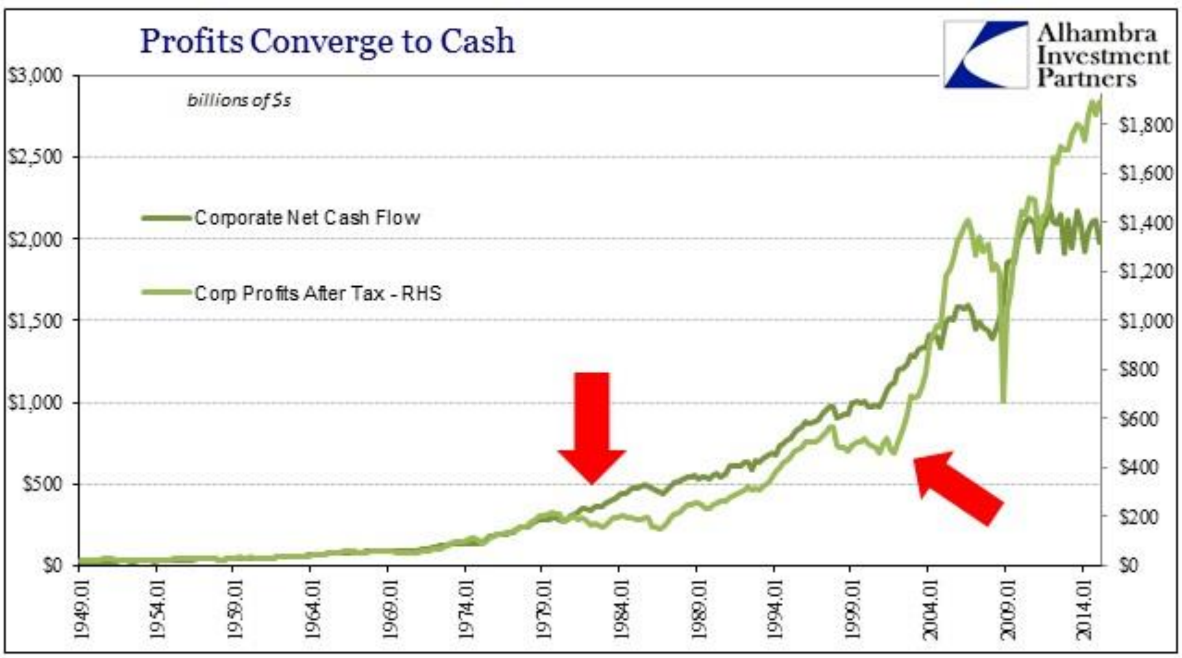
The one statistic that stands out against that view is the various versions of employment count. However, the BLS figures on payrolls are causing numerous and severe problems with downstream calculations – suggesting, highly, that payrolls are being over-estimated.



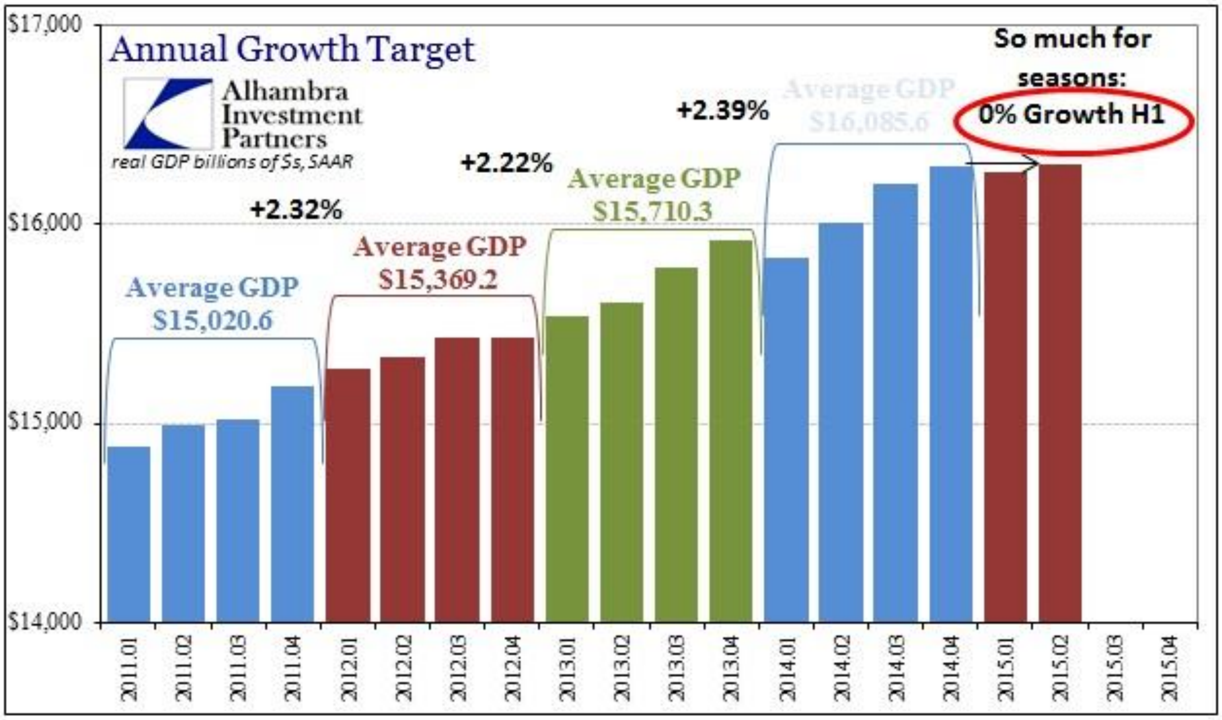
The steeper upward slope of chained variation in the payroll report means that, given declines in output dating back more than a year, productivity is 'forced' to be negative. Negative productivity pushes the cost of marginal labor up to historically high levels, undermining the very reason that businesses would be adding workers at such a robust pace in the first place.



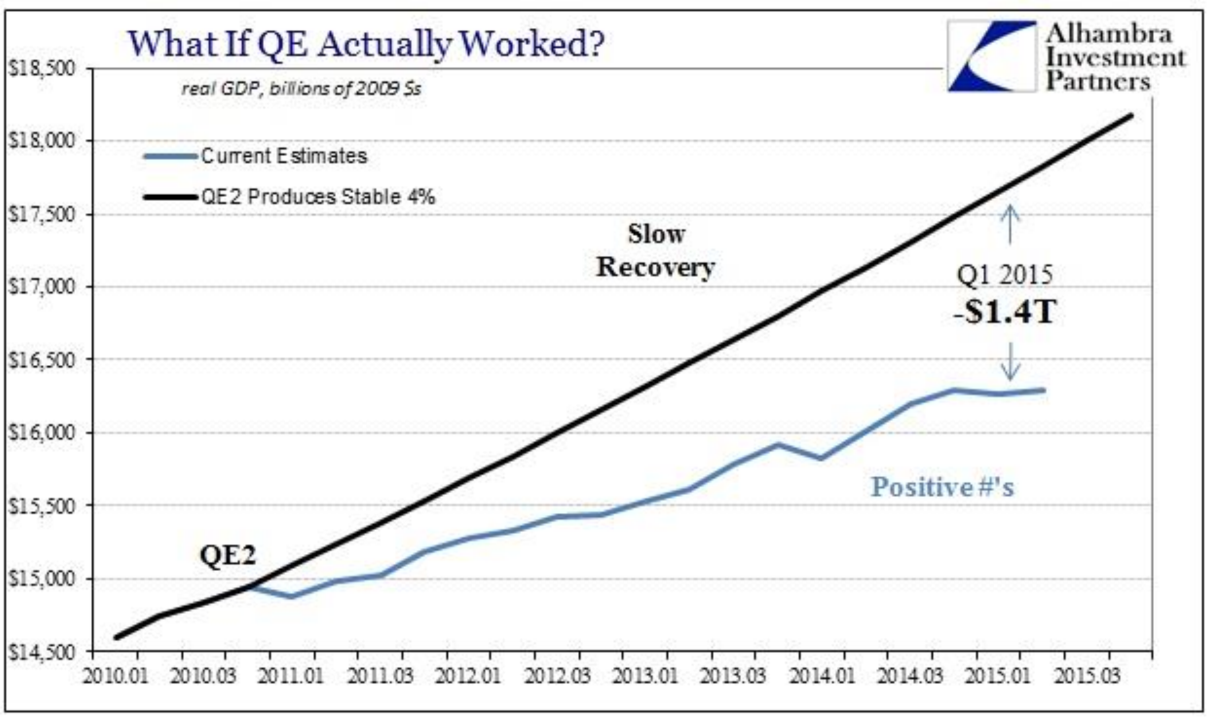
Typically, high marginal labor costs are seen at the very end of business cycles not the start of a new growth phase. Either the BLS is overstating labor growth or the businesses are heading right for a cycle turn.



Further, cash flow estimates from the GDP view have been stagnant since 2011, maybe even 2010. That would fit within the idea of the 2012 slowdown while also directly against a tremendous payroll expansion.

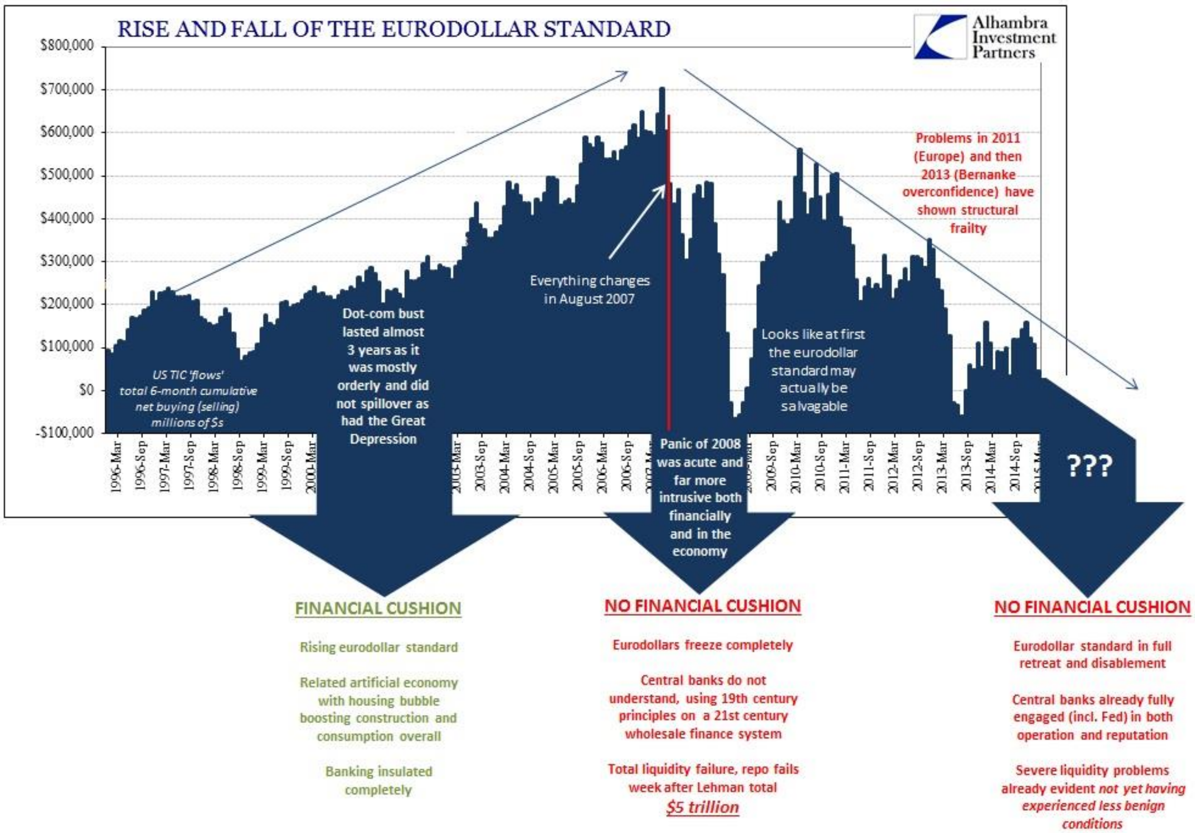


Even GDP itself no longer conforms to the narrative set by the Establishment Survey and unemployment rate. Growth has tailed off dramatically not just in consumer metrics but in GDP itself (which is significant since GDP is constructed to show the most charitable view of the economy). Current estimates place not a problem with just Q1 but so far the entire first half of 2015.

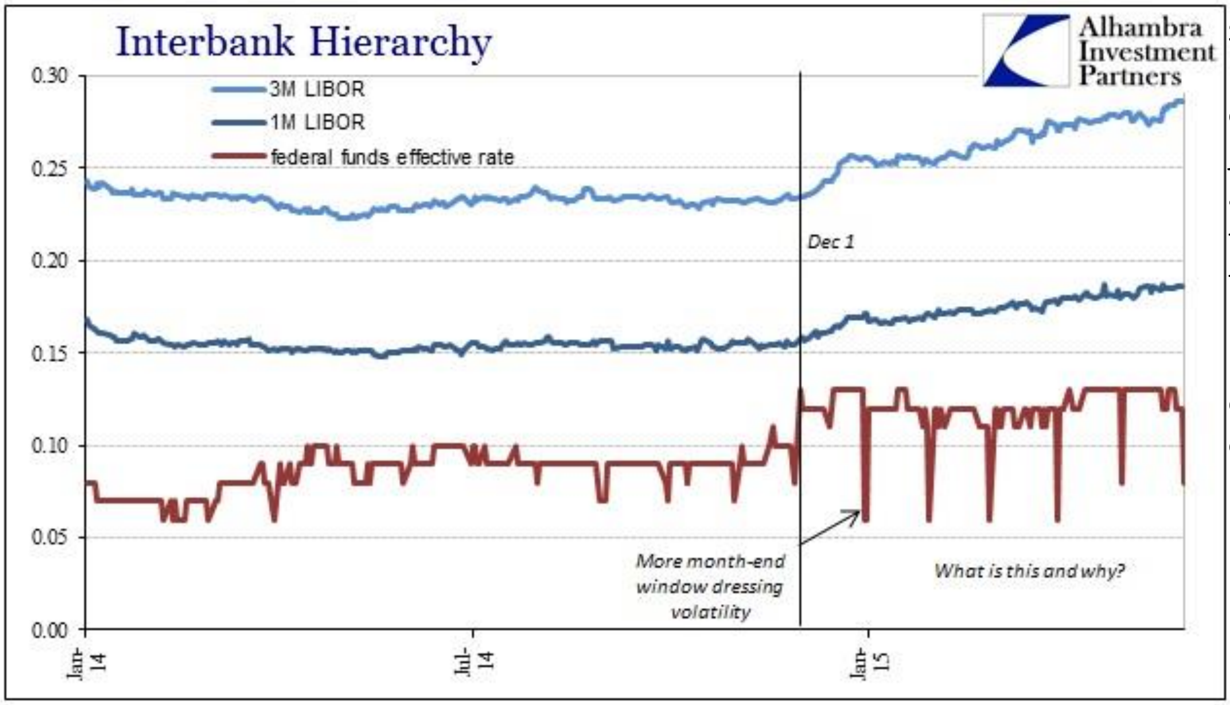


Overall, economic growth has not lived up to the expectations necessary for maintaining the Yellen Doctrine – not even close. That has not been a problem to this point because 'there is always next year' has become somewhat of syndrome. That is why flagging economic fortunes in 2015 are more serious and dangerous, as the potential is for total economic disavowal of that 'necessary' future growth.

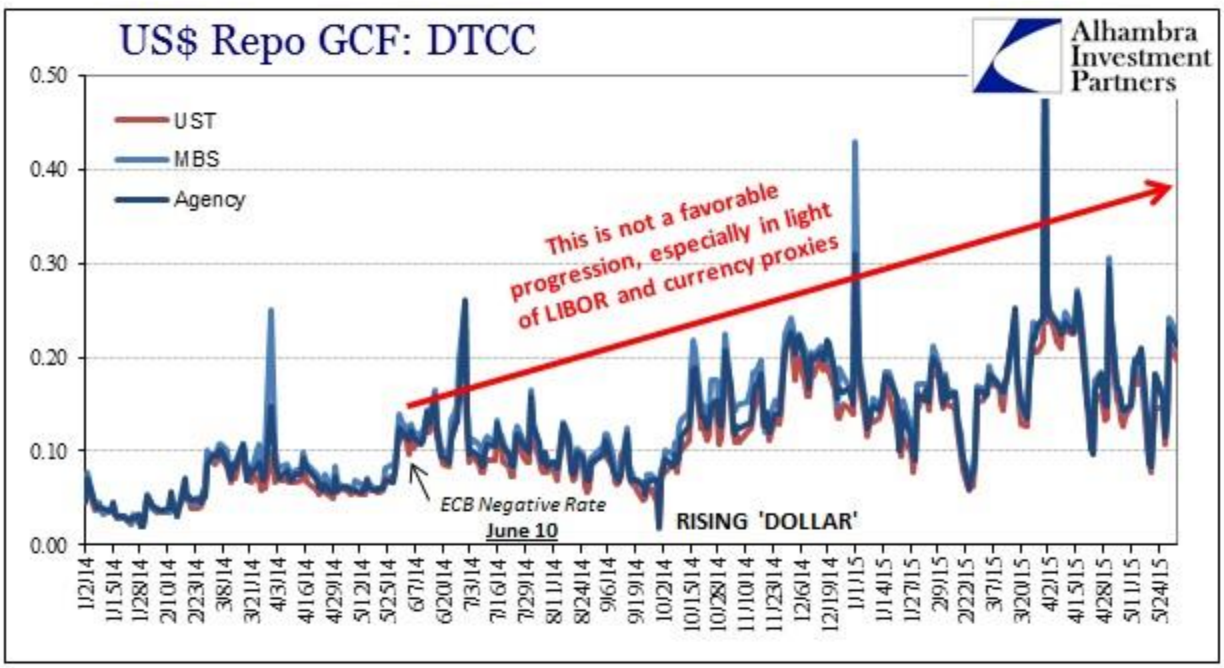
PART 2: Liquidity for the ‘Turn’



The second part of the Yellen Doctrine wishes for , if a wave of selling, an orderly withdrawal of asset imbalance not unlike the dot-com bubble. Despite the massive size, there was little economic damage which has been credited to Alan Greenspan and monetary ‘genius.’ None of that makes sense; instead the rising eurodollar standard provided the necessary cushion. Unfortunately for Yellen’s tenure, the eurodollar standard has been on consistent and persistent decay since August 2007 – recently reaching very concerning levels.



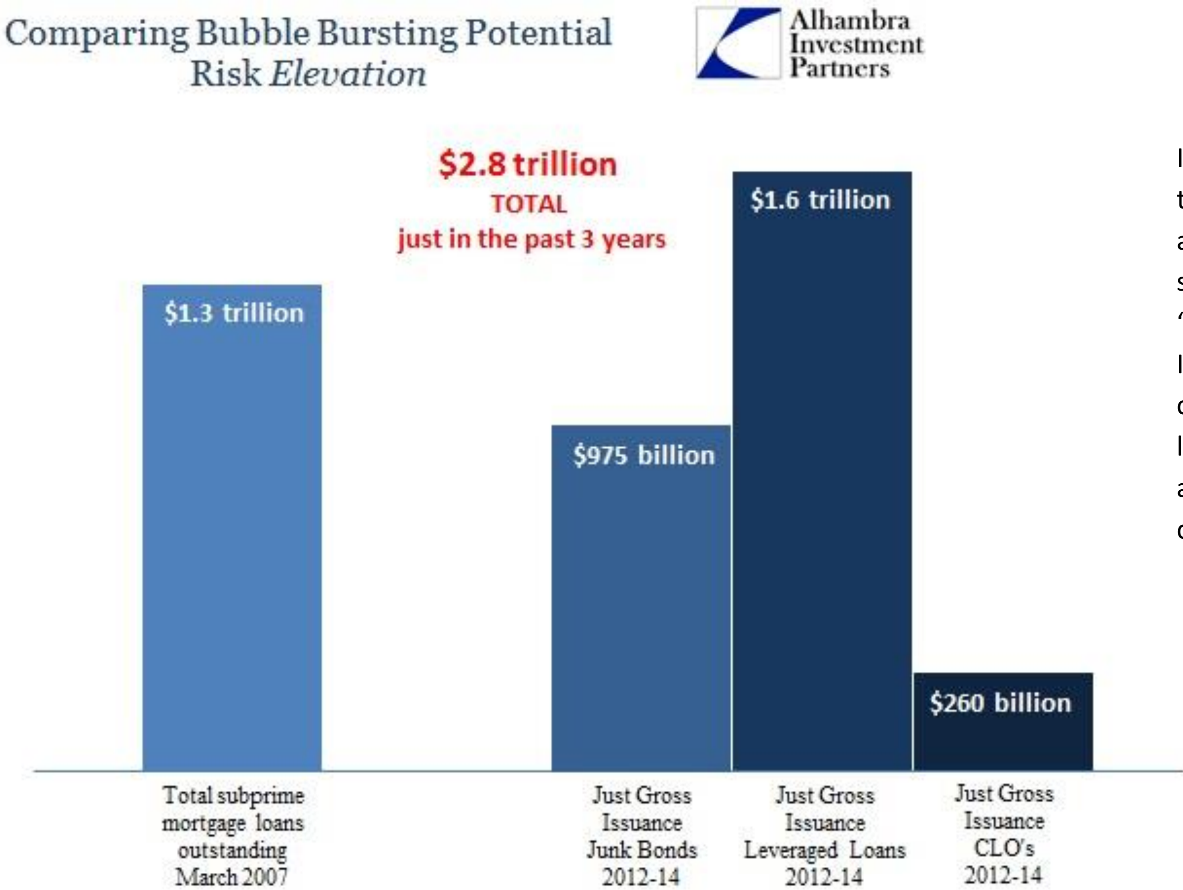
Since Dec 1, interbank stress has been rising in various outlets. That includes not just eurodollars (LIBOR) but also the nearly non-existent federal funds market which the Fed still holds as its key monetary lever (due to psychology being the dominant aim, not money or even liquidity).



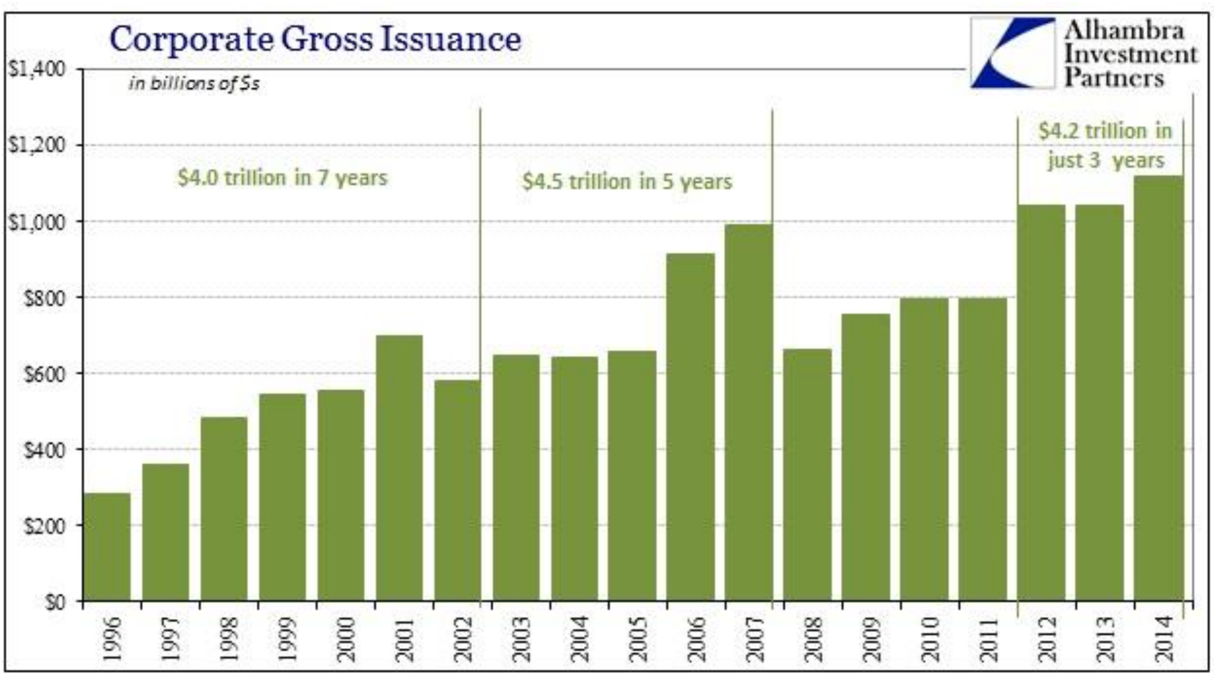
Repo markets have been growing more and more unstable for more than a year now, with a decided turn toward irregularity around October 15 and that liquidity 'episode.'

Systemic liquidity problems have been a near-constant feature since early 2013, shortly after QE4 commenced, due to collateral positions and ultimately dealers having been far too one-sided (showing up in the interest rate swap market, a primary liquidity conduit, among other places) through QE-driven expectations.

That sentiment is corroborated as even gold's early 2013 collapse related not to better economic fortunes (as giddy economists were so sure of at that time) but rather heighted and dramatic 'dollar' problems. Gold's price action these past two years was a warning that has been carried out all over the financial system.



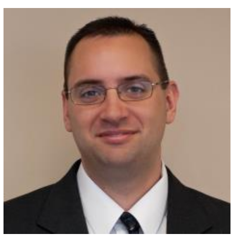
If there is a necessary ‘spark’ to turn benign investor apathy into determined selling, there is plenty of ‘fuel’ for that to take place. In especially higher risk corporate securities, there is little to no cushion in yields and spreads compressed so dramatically as they are now.



While mortgages are no longer an issue (that was the last battle) there is still massive financial imbalance only shifted in form and placement. Yellen and central banks find that as a means of success all its own (as if the economy weren't the real goal) without suggesting the risks for it.

The risks are spelled out here: systemic liquidity in overall decay already showing signs of strain without a persistent selling character. Combined with the enormous amount of risk contained within the corporate explosion already, especially at prices that provide no risk/reward or cushion for absorbing fundamental change, suggests the second part of the Yellen Doctrine as wholly degraded.

As to the first, economic growth has never lived up to expectations, but until now had at least been mostly positive enough to keep the 'there is always next year' plausible enough. The potential of an extended or even worsening slump in 2015, recession or not, is to finally undermine that sentiment. What is left holding the asset bubbles in place is, as is typical, very little and eroding.



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