Alhambra Investment Partners

BI -WEEKLY ECONOMIC REVIEW

Economic Releases

Report	Prior	Consensus	Actual
Labor Market Conditions	-0.5	2.3	1.3
JOLTS - Job Openings	5.109M	5.038M	5.376M
Wholesale Trade			
Inventories	0.2%	0.3%	0.4%
Inventory/Sales	1.3		1.29
Quarterly Services Survey			
Q/Q	1.30%		0.40%
Jobless Claims	277K	275K	279K
Retail Sales	0.2%	1.3%	1.2%
Less Autos & Gas	0.2%	0.5%	0.7%
Export Prices Y/Y	-6.3%		-5.9%
Import Prices Y/Y	-10.7%		-9.6%
Business Inventories	0.10%	0.20%	0.40%
Inventory/Sales	1.36		1.36
PPI	-0.4%	0.4%	0.5%
Less Food & Energy	-0.2%	0.1%	0.1%
Consumer Sentiment	90.7	91.2	94.6
Empire State Mfg. Survey	3.09	5.90	-1.98
Industrial Production	-0.5%	0.2%	-0.2%
Housing Market Index	54	56	59
Housing Starts	1.165M	1.090M	1.036M
Permits	1.140M	1.105M	1.275M
CPI	0.1%	0.5%	0.4%

Less Food & Energy	0.3%	0.2%	0.1%
Jobless Claims	279K	275K	267K
Current Account	-103.5B	$-116.5B	113.5B
Philly Fed Outlook	6.7	8.0	15.2
Leading Indicators	0.7%	0.4%	0.7%

Items highlighted in green were reported better than consensus while those in red were worse than expected. Black were in line.

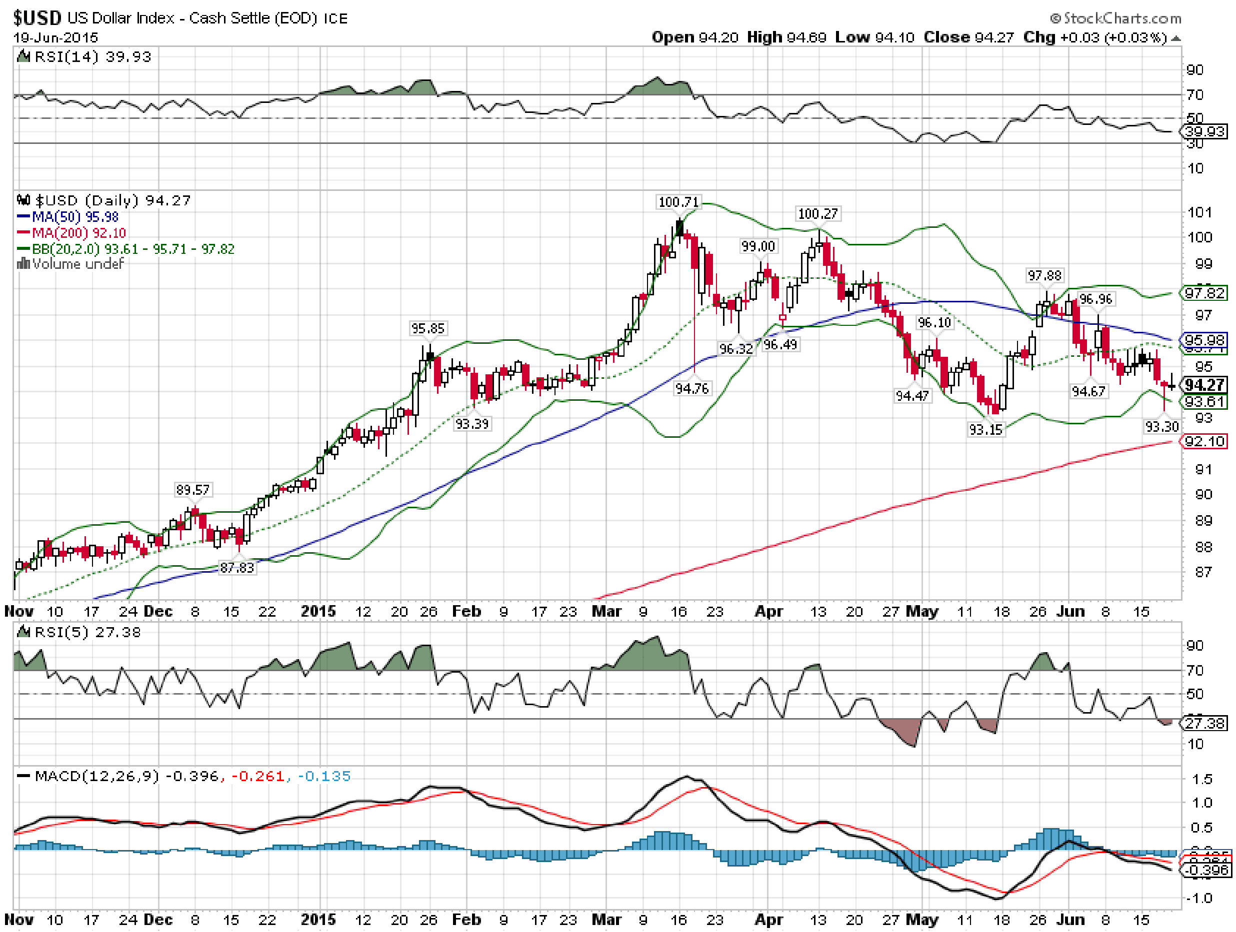
The incoming high frequency economic data continued to improve relative to expectations over the last two weeks. As I've stressed in previous reports though, better than expected is not necessarily good - just better than much reduced expectations regarding growth. The Fed even acknowledged that reality this week by finally moving their dot plot down and reducing their own always-lagging-reality growth forecasts.

About the only way the economic data is important at this point is how it is perceived to affect monetary policy. Everyone is focused like a laser on when the Fed will hike rates and believe – for some reason – that parsing the data closely enough will give them a heads up that no one else will get. I have serious doubts about that not least because the Fed doesn't want to upset or surprise anyone. Furthermore, even if one knew when the Fed would get off the zero bound it is folly to believe that one could know the consequences of such a move.

I personally do not believe that we will see a rate hike this year and maybe not even well into next year. There is a lot more slack in the economy – a concept Yellen holds dear – than perceived by the mainstream. That can be seen in the last employment report which showed a solid gain in monthly jobs and also an *uptick* in the unemployment rate as people started to return to the workforce. There's still a lot of idle labor out there and I don't buy that it is all because of a skills mismatch. Fears over a wage/price spiral are way, way overwrought.

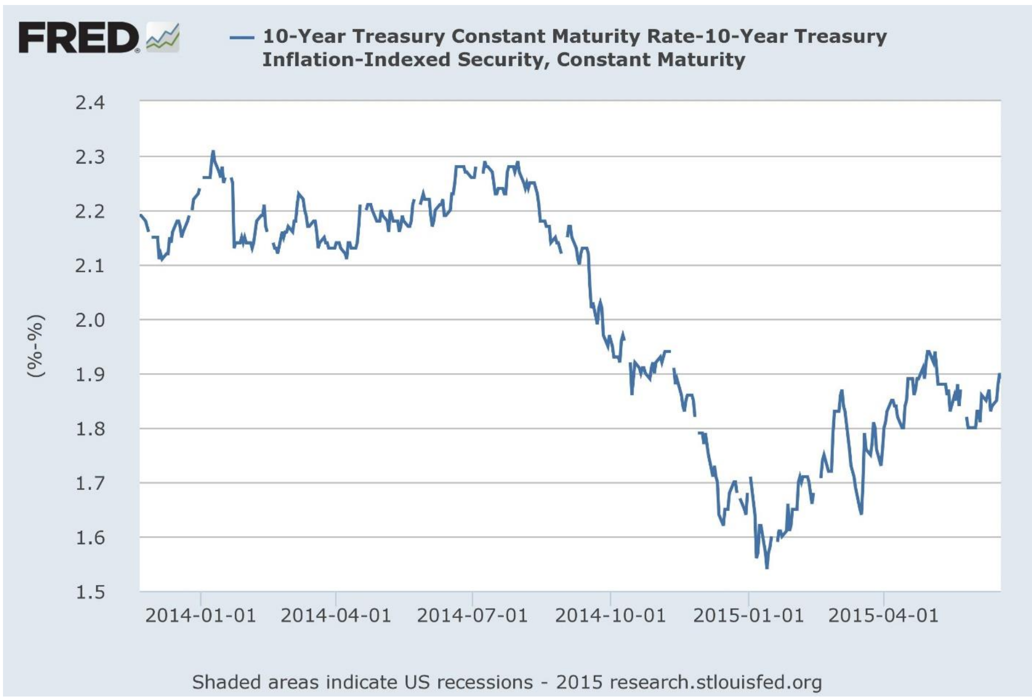
I don't spend a lot of time on the economic data itself, believing that the reaction to the data is much more important than the actual data (Keynes beauty contest and all that). If you want to know how US growth prospects are perceived look at the dollar (versus other currencies as well as against gold and other commodities), the yield curves and credit spreads. That will tell you 90% of what you need to know about the big macro picture. More detail from the reports can be applied in micro fashion (parse the housing reports for clues about home builders and suppliers to home builders for instance) with the caveat that most of them are near worthless until revised at least once.

The dollar right now is particularly interesting in that regard as it appears to have peaked, at least short term, even as the talking heads on CNBC and Bloomberg continue to jabber about a “strong” dollar. Since some seem to have missed it, here’s a chart that shows pretty plainly that the dollar topped in mid-March. Not exactly news now is it?



Of course, the dollar index doesn’t really tell you about US growth expectations in isolation but rather relative to the other currency areas in the index (primarily the Euro and Yen but we’ve seen emerging market currencies also improve lately). The drift lower since March is, in my opinion, an equalizing of growth expectations between the US and the rest of the world, something I talked about several times in commentaries early in the year.

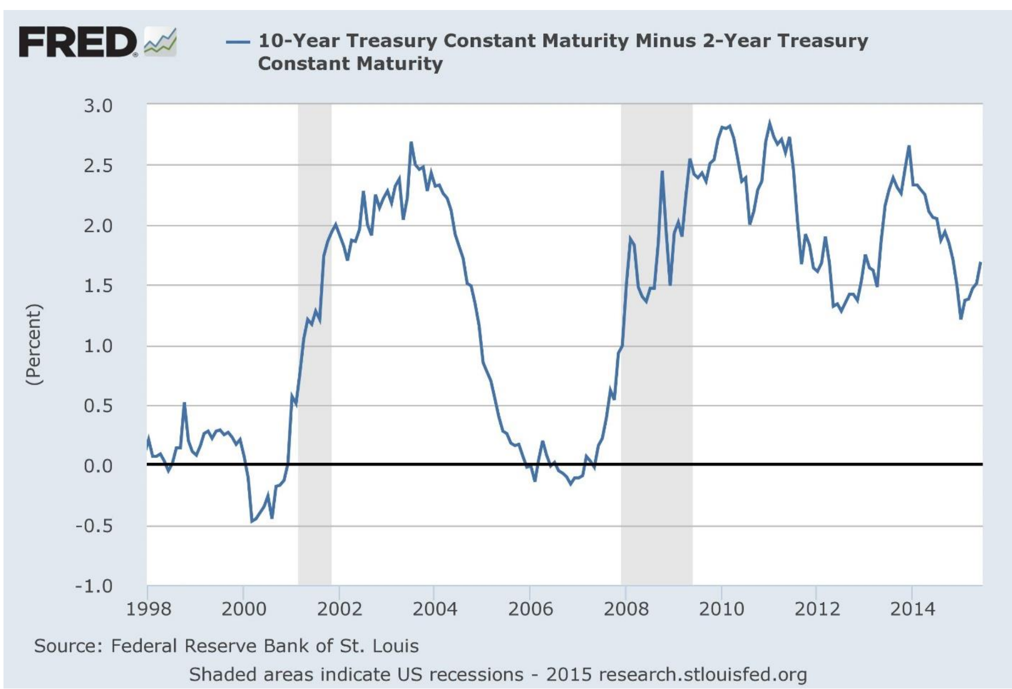
That would seem to be more a story about Europe and the rest of the world than it is about the US. Absolute US growth expectations have actually risen since mid-March, something we can observe from the bond market. Both nominal and inflation protected (TIPS) 10 year Treasury bond yields have risen since the dollar peak in mid-March with nominal yields rising faster than real yields. That tells us that inflation expectations have risen faster than real growth expectations but both have risen.



That would seem to tell a story of growth expectations for the rest of the world rising even faster than US growth expectations, something I think most people would find surprising given their fears about Grexit and the China “bubble”. I don’t think there are a lot of investors even aware of this and certainly very few who are investing based on it. If you read my note on Global Asset allocation last week, you know we are overweight international versus the US right now and have been for some time.

Yield Curves

The steepening trend in yield curves continues and is starting to concern me more. We have not had to deal with a steepening of the curve - with the economy still expanding and maybe even improving - from a level more than flat in a long time. In general, the yield curve flattens as monetary policy is tightened and starts steepening as the economy stumbles from higher rates and the market starts to anticipate another easing cycle. That obviously isn't the case this time as the curve never reached flat and is already steepening even before the tightening – at least officially – has started. It seems that the market took the anticipation of the end of QE3 and its actual end as the tightening part of the cycle. Is the bond market now anticipating further easing? Another QE? For now, I think it appropriate to watch the TIPS market for clues about growth and if those start to fall then we may have reason to further reduce our risk exposures.



I am concentrating on the 10/5 curve now because of the Fed's influence over the shorter end of the curve. I divide the curve into zones:

Zone 0 = Inverted

Zone 1 = 0.0% to 0.25%

Zone 2 = 0.25% to 0.50%

Zone 3 = 0.50% to 0.75%

Zone 4 = 0.75% and higher

Recession probability:

Zone 0 = 50%+

Zone 1 = 25 – 50%

Zone 2 = 15 – 25%

Zone 3 = 5 – 15%

Zone 4 = 0 – 5%

We are still in ***Zone 3*** with the 10/5 curve at 0.70 which translates to a fairly low probability of recession. However, as I've said before, we are in a bit of uncharted territory here. In a normal cycle we would have reached at least Zone 1 and more likely 0 where we would be sitting at a minimum risk exposure. We wouldn't then adjust our exposures until we reached at least Zone 3 as the curve would steepen during recession and monetary easing. It is an interesting puzzle but one where I think one should probably err on the side of caution. If we move into Zone 4 from here I will not likely up my risk allocation unless markets have already corrected significantly.

Credit Spreads

Combining the yield curve with credit spreads starts to paint a more worrisome picture. Credit spreads continued to move wider since the last update two weeks ago. They are not yet at levels we would associate with recession but they are definitely moving in the wrong direction. And as I've pointed out in previous updates, it is across the full spectrum of credit ratings with even AAA credit spreads moving wider. In other words, contrary to most commentary, this is not just about the shale bust. Most of those companies are junk rated. This is definitely something to keep an eye on for stock investors; credit spreads have a correlation of -0.80 to the stock market so when spreads move wider, stocks go down.

Calendar

Monday Jun 22	Tuesday Jun 23	Wednesday Jun 24	Thursday Jun 25	Friday Jun 26
Market Focus » **International Perspective »** **Simply Economics »** Chicago Fed National Activity Index 8:30 AM ET Existing Home Sales CONSENSUS 10:00 AM ET	Durable Goods Orders CONSENSUS 8:30 AM ET Redbook 8:55 AM ET FHFA House Price Index CONSENSUS 9:00 AM ET PMI Manufacturing Index Flash CONSENSUS 9:45 AM ET	Bank Reserve Settlement MBA Mortgage Applications 7:00 AM ET GDP CONSENSUS 8:30 AM ET Corporate Profits 8:30 AM ET EIA Petroleum Status Report 10:30 AM ET	*Weekly Bill Settlement* *52-Week Bill Settlement* Jobless Claims CONSENSUS 8:30 AM ET Personal Income and Outlays CONSENSUS 8:30 AM ET PMI Services Flash	*2-Yr FRN Note Settlement* Consumer Sentiment CONSENSUS 10:00 AM ET **Esther George Speaks** 12:45 PM ET

4-Week Bill Announcement 11:00 AM ET 3-Month Bill Auction 11:30 AM ET 6-Month Bill Auction 11:30 AM ET	New Home Sales CONSENSUS 10:00 AM ET Richmond Fed Manufacturing Index 10:00 AM ET 4-Week Bill Auction 11:30 AM ET 52-Week Bill Auction 11:30 AM ET 2-Yr Note Auction 1:00 PM ET	2-Yr FRN Note Auction 11:30 AM ET 5-Yr Note Auction 1:00 PM ET	CONSENSUS 9:45 AM ET Bloomberg Consumer Comfort Index 9:45 AM ET EIA Natural Gas Report 10:30 AM ET Kansas City Fed Manufacturing Index 11:00 AM ET 3-Month Bill Announcement 11:00 AM ET 6-Month Bill Announcement 11:00 AM ET 7-Yr Note Auction 1:00 PM ET Fed Balance Sheet 4:30 PM ET Money Supply 4:30 PM ET	
Monday Jun 29	Tuesday Jun 30	Wednesday Jul 1	Thursday Jul 2	Friday Jul 3
Pending Home Sales Index 10:00 AM ET	*2-Yr Note Settlement* *5-Yr Note*	Motor Vehicle Sales	*Weekly Bill Settlement*	*Markets Closed, Banks open*

Dallas Fed Mfg Survey 10:30 AM ET 4-Week Bill Announcement 11:00 AM ET 3-Month Bill Auction 11:30 AM ET 6-Month Bill Auction 11:30 AM ET Farm Prices 3:00 PM ET	*Settlement* *7-Yr Note Settlement* *30-Yr TIPS Settlement* **James Bullard Speaks** Redbook 8:55 AM ET S&P Case-Shiller HPI 9:00 AM ET Chicago PMI 9:45 AM ET Consumer Confidence 10:00 AM ET State Street Investor Confidence Index 10:00 AM ET	MBA Mortgage Applications 7:00 AM ET Challenger Job-Cut Report 7:30 AM ET ADP Employment Report 8:15 AM ET Gallup U.S. Job Creation Index 8:30 AM ET Gallup US Payroll to Population 8:30 AM ET PMI Manufacturing Index 9:45 AM ET ISM Mfg Index 10:00 AM ET Construction Spending 10:00 AM ET	Employment Situation 8:30 AM ET Jobless Claims 8:30 AM ET Bloomberg Consumer Comfort Index 9:45 AM ET Factory Orders 10:00 AM ET EIA Natural Gas Report 10:30 AM ET 3-Month Bill Announcement 11:00 AM ET 6-Month Bill Announcement 11:00 AM ET 3-Yr Note Announcement 11:00 AM ET	

	4-Week Bill Auction 11:30 AM ET	EIA Petroleum Status Report 10:30 AM ET	10-Yr Note Announcement 11:00 AM ET 30-Yr Bond Announcement 11:00 AM ET *SIFMA Rec. Early Close 2:00 ET* Fed Balance Sheet 4:30 PM ET Money Supply 4:30 PM ET	

Joseph Y. Calhoun III
CEO of Alhambra Investment Partners, LLC

"Wealth preservation and accumulation through thoughtful investing."

For information on Alhambra Investment Partners' money management services and global portfolio approach to capital preservation, Joe Calhoun can be reached at:

786-249-3773
Jyc3@alhambrapartners.com