Alhambra Investment Partners

BI -WEEKLY ECONOMIC REVIEW

Economic Releases

Report	Prior	Consensus	Actual
Chicago Fed Nat'l Activity Index	-0.19		-0.17
Existing Home Sales	5.09M	5.25M	5.35M
Durable Goods Orders	-1.5%	-0.6%	-1.8%
Ex Transportation	-0.3%	0.5%	0.5%
PMI Manufacturing Flash Index	53.8	54.2	53.4
New Home Sales	534K	525K	546K
Richmond Fed Manufacturing Index	1		6
GDP	-0.7%	-0.2%	-0.2%
Price Deflator	-0.1%	-0.1%	0.0%
Corporate Profits	9.2%		9.0%
Jobless Claims	268K	273K	271K
Personal Income	0.5%	0.4%	0.5%
Consumer Spending	0.1%	0.7%	0.9%
PCE Price Index	0.0%	0.3%	0.3%
PMI Services Flash	56.4	56.5	54.8
KC Fed Manufacturing Index	-13.0		-9.0
Consumer Sentiment	94.6	94.6	96.1
Pending Home Sales	111.6		112.6
Dallas Fed Manufacturing Survey	-20.8	-13.5	-7.0
Case Shiller HPI	1.0%	0.8%	0.3%
Chicago PMI	46.2	50.6	49.4
Consumer Confidence	94.6	97.4	101.4
Motor Vehicle Sales - Domestic	14.2M	13.6M	13.6M
Challenger Job Cuts	41034		44842
ADP Employment	203K	220K	237K
PMI Manufacturing Index	54.0	53.7	53.6
ISM Manufacturing Index	52.8	53.2	53.5

Construction Spending	2.1%	0.5%	0.8%
Employment Situation	254K	230K	223K
Unemployment Rate	5.5%	5.4%	5.3%
Participation Rate	62.90%		62.60%
Avg Hourly Earnings	0.2%	0.2%	0.0%
Jobless Claims	271K	270K	281K
Factory Orders	-0.7%	-0.3%	-1.0%

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

The economic data over the last two weeks appears to have improved somewhat versus expectations. It isn't as if the economy is taking off or anything but analysts seem to have caught up to the data trend. I am a bit skeptical of the areas of improvement, particularly real estate. With the widespread expectation that the Fed will hike rates later this year, it may be that the recent jump in home sales is nothing more than an attempt to beat the rate hikes and get financing while the getting is good. A lot of the other reports beating expectations are more survey based rather than hard data and carry less weight in my book. Consumer confidence is always highest just before things go south. Of continuing concern is the manufacturing side of the economy which is struggling. Factory orders are down 8 or the last 9 months and not be an inconsiderable amount. If it was the only indicator you had, your conclusion would have to be that the US economy is in recession. And so it is also worrisome that we have seen several of the service sector surveys recently miss expectations. Again, I don't place as much emphasis on survey data but with manufacturing already in recession territory anything that points to a slowdown in services is very concerning.

The employment report was in my opinion a quite poor showing. While most reports concentrated on the drop in the participation rate what concerns me more is the revisions lower of past months. Economic data tends to have a momentum of its own but we often don't see that momentum until after the fact as old data gets revised. A consistent pattern of negative revisions is not a positive sign.

The US dollar moved a bit higher over the last two weeks; not exactly surprising given the Greek tragedy unfolding in Europe and what is either a crash or a major correction in Chinese stocks. But if you knew a couple of weeks ago that Greece would be on the verge of quitting the Euro and Chinese stocks would be down 30% from their highs wouldn't you have expected a bigger bid for dollars? I know I would have. It would seem that weak US growth is just as big a concern as what dominates the headlines.

Of course, a Euro without Greece in it would seem a more attractive currency so maybe the fact the Euro hasn't fallen on fears of Grexit are perfectly rational. I would think that any major concessions on the part of the EU to keep Greece in would more likely be a trigger for Euro selling. In any case, we seem likely to find out soon with Greeks going to the polls this weekend.

As for China and its stock market woes, it must be remembered that the markets we're talking about are mostly for domestic investors. And they have nowhere else to go with their money so a stock market crash doesn't mean capital outflows; the effect on the dollar is minimum.

Yield Curve

The yield curve steepening trend remains intact although there wasn't much movement the last two weeks. Inflation expectations fell a bit while real growth expectations were essentially unchanged.

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%

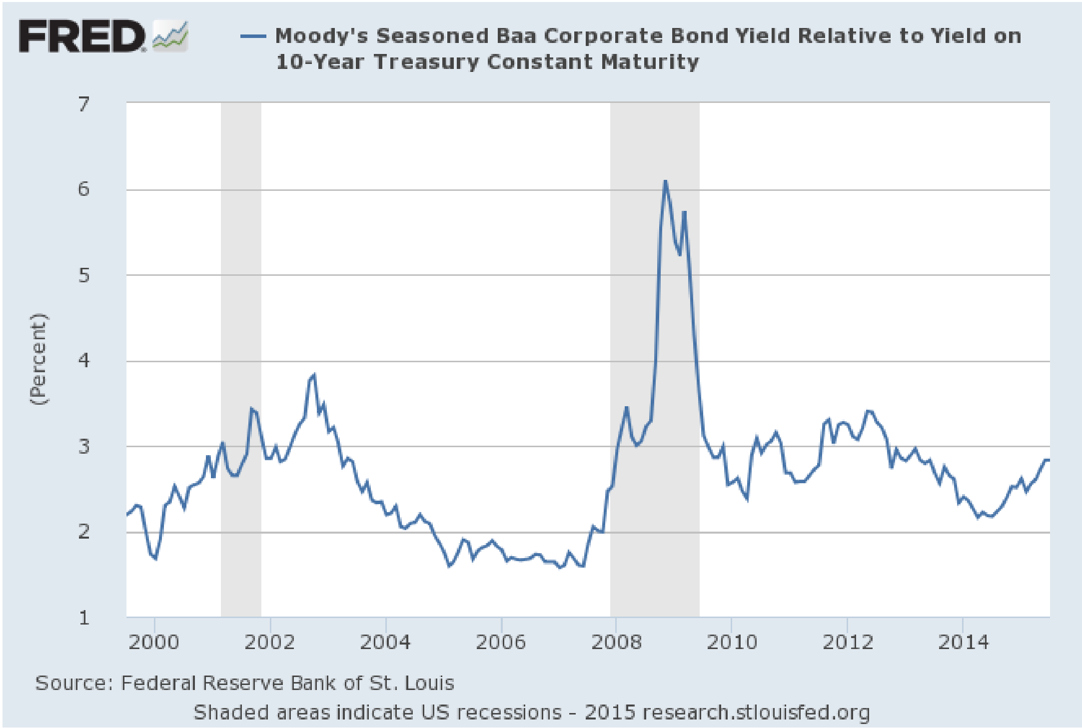
Zone 3 = 5 – 15%

Zone 4 = 0 – 5%

We are still in ***Zone 3*** with the 10/5 curve at 0.72 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

Credit spreads continue their negative trend. Baa spreads have now widened past the level at the beginning of the last recession and within a few basis points of the recession earlier in the century. However, it should be noted that despite the trend, spreads did not move sufficiently on the month to trigger a secondary sell signal. That would require a move of at least 7.5% in the spread month to month and this month's move, while obviously in the wrong direction, does not meet that threshold.



Overall the message of the yield curve, credit spreads and incoming data is one of caution. Manufacturing is struggling while services continue to support growth – for now. We do not have sufficient evidence yet, in aggregate, to say that the US economy is headed for recession imminently. The trend remains one of slow, below trend growth of 2 to 2.5%. Based on the first half of the year about all I can say is that we may be shifting that range down to one that has 2% as the top end.

Calendar

Monday Jul 6	Tuesday Jul 7	Wednesday Jul 8	Thursday Jul 9	Friday Jul 10
Market Focus » **International Perspective »** **Simply Economics »** Gallup US Consumer Spending Measure 8:30 AM ET PMI Services Index CONSENSUS 9:45 AM ET Labor Market Conditions Index 10:00 AM ET ISM Non-Mfg Index CONSENSUS 10:00 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	International Trade CONSENSUS 8:30 AM ET Gallup US ECI 8:30 AM ET Redbook 8:55 AM ET JOLTS 10:00 AM ET 4-Week Bill Auction 11:30 AM ET 3-Yr Note Auction 1:00 PM ET Consumer Credit CONSENSUS 3:00 PM ET Treasury STRIPS 3:00 PM ET	Bank Reserve Settlement MBA Mortgage Applications 7:00 AM ET EIA Petroleum Status Report 10:30 AM ET 10-Yr Note Auction 1:00 PM ET **John Williams Speaks** 2:00 PM ET FOMC Minutes 2:00 PM ET	*Weekly Bill Settlement* Chain Store Sales **Narayana Kocherlakota Speaks** 5:45 AM ET Jobless Claims CONSENSUS 8:30 AM ET Bloomberg Consumer Comfort Index 9:45 AM ET **Lael Brainard Speaks** 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 **Esther George Speaks** 12:30 PM ET	Wholesale Trade CONSENSUS 10:00 AM ET **Eric Rosengren Speaks** 11:30 AM ET **Janet Yellen Speaks** 12:00 PM ET

TD Ameritrade IMX 12:30 PM ET			30-Yr Bond Auction 1:00 PM ET Fed Balance Sheet 4:30 PM ET Money Supply 4:30 PM ET	

Monday Jul 13	Tuesday Jul 14	Wednesday Jul 15	Thursday Jul 16	Friday Jul 17
4-Week Bill Announcement 11:00 AM ET 3-Month Bill Auction 11:30 AM ET 6-Month Bill Auction 11:30 AM ET Treasury Budget 2:00 PM ET	NFIB Small Business Optimism Index 6:00 AM ET Retail Sales 8:30 AM ET Import and Export Prices 8:30 AM ET Redbook 8:55 AM ET Business Inventories 10:00 AM ET 4-Week Bill Auction 11:30 AM ET	*3-Yr Note Settlement* *10-Yr Note Settlement* *30-Yr Bond Settlement* MBA Mortgage Applications 7:00 AM ET PPI-FD 8:30 AM ET Empire State Mfg Survey 8:30 AM ET Industrial Production 9:15 AM ET Atlanta Fed Business Inflation Expectations 10:00 AM ET **Janet Yellen Speaks** 10:00 AM ET	*Weekly Bill Settlement* Jobless Claims 8:30 AM ET Bloomberg Consumer Comfort Index 9:45 AM ET Philadelphia Fed Business Outlook Survey 10:00 AM ET Housing Market Index 10:00 AM ET **Janet Yellen Speaks** 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	

		EIA Petroleum Status Report 10:30 AM ET **Loretta Mester Speaks** 12:25 PM ET Beige Book 2:00 PM ET **John Williams Speaks** 3:00 PM ET	52-Week Bill Announcement 11:00 AM ET 10-Yr TIPS Announcement 11:00 AM ET Treasury International Capital 4:00 PM ET Fed Balance Sheet 4:30 PM ET Money Supply 4:30 PM ET	

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"Wealth preservation and accumulation through thoughtful investing."

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