Investor Sentiment, Global Debt, Market Comments: Short and to the point.

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By Steve Blumenthal

Investor Sentiment

Sentiment continues to rise from last month's Extreme Pessimism reading and is now in the neutral zone (neither Extremely Pessimistic nor Excessively Optimistic). This is generally positive and I believe sentiment continues to support a further equity market rally. I continue to favor a "risk on" environment (which I indicated in my June 14 piece when the S&P 500 Index was at 1315. The S&P closed at 1385 on July 30, 2012). I will again recommend that hedges be put in place when Sentiment moves into the Excessive Optimism zone. It is "risk on" for now.

Fed Stimulus and the S&P 500

Note the impact that Quantitative Easing has had on the S&P. This aggressive monetary policy was/remains targeted towards a specific goal; push up prices of risk assets in an attempt to stimulate economic growth.

From Some Very Smart Guys

PIMCO's "New Normal" called for long-term deleveraging, lower growth and modest investment returns as the economy reversed course. It called for increased regulation and reduced globalization. It said there would be no V-shaped recovery that is typically seen after a recession. It called for a long, hard adjustment period with sustained high unemployment and it called for a transition of stress from private balance sheets to sovereign balance sheets. With the benefit of hindsight, those calls were accurate.

Each year PIMCO gathers their top analysts in what they call their "Secular Forum" to debate their three to five year outlook for the global economy and financial markets. Importantly, the focus is on the long term. Mohamed El-Erian published a summary of their conclusions titled "Policy Confusions and Inflection Points". Click here to read this summary.

Their updated secular outlook calls for continued deleveraging, slow real economic growth in the U.S. of 1 to 2 percent, a likely recession in the Eurozone tied to the ongoing debt crisis, and slowing growth in emerging markets. With moderate overall global economic growth, markets will be more vulnerable to shocks.

U.S. Debt
In 2010, the U.S. government borrowed (the Fed printed currency then used that money to buy U.S. government bonds) to the tune of $0.55 cents for every dollar it spent. This year the Fed has bought nearly 61% of all newly issued government bonds. In the U.S., we borrow by printing new money to buy the issued bonds and we continue to spend $1 trillion per year more than we are taking in tax receipts.

Following is some less-than-pleasant data:

- Total net federal debt issued from September 2008 through July 2010 was $3.35 trillion.
- Gross individual tax receipts came to $3.19 trillion over that period. Minus refunds of $660 billion, the net individual tax receipts came to $2.5 trillion.
- Add the corporate receipts of $250 billion, net of refunds, and the total net tax revenue came to $2.78 trillion. In other words, the fiscal policy of the U.S. government was to borrow $0.55 cents for every $0.45 cents in net tax revenue receipts.
  source: www.strategicinvestment.com

History shows that the end of the debt cycle is painful. Could it be different this time? I wouldn't take that bet.

From Phoenix Capital Research: "We have not had a period in which the Fed wasn't pumping tens of billions into the markets since 2007. Indeed, the only time the Fed wasn't officially pumping its brains out was between the end of QE1 (April 2010) and the announcement of QE lite (August 2010)."

This certainly supports the Fed's desire to drive up prices in an attempt to stimulate economic growth.

Some Stats on Economic Growth – Simply Too Much Debt
Source: www.strategicinvestment.com, data through 2009,

- U.S. GDP growth averaged 3.4% from 1889 to 2009
- U.S. GDP growth averaged 3.6% from 1939 to 2009
- Over the last 60 years it was 3.3%
- Over the last 50 years it was 3.1%
- Over the last 40 years it was 2.8%
- Over the last 30 years it was 2.7%
- Over the last 10 years it was 1.9%
- Over the last 5 years it was 0.9%
- The current 3 year growth is zero

"One of the hidden problems is that an ever-greater percentage of the economic activity is attributed to government spending that is financed by borrowed money since the U.S. continues to spend far more than it takes in. Growth of the real private economy has been even more meager."
** source: www.strategicinvestment.com*

This is unhealthy. You wouldn't run your business this way and you wouldn't run your household this way.

In summary, I believe debt will continue to be a major drag on growth both here and abroad. The markets will respond to the Fed's quantitative easing as referenced in the chart above. It is "risk on" tied to liquidity and Fed manipulation and "risk off" when it goes away. We'll work our way through this mess over time; however, be careful to not get

emotionally pulled into or out of the markets at the wrong time. I believe we are in a period of continued volatility that requires a focus on broad asset class diversification and disciplined risk management.

With kindest regards,

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