Weekly Marketmail

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Is the "Worst Quarter since 2009" a Correction or a New Bear?

By Louis Navellier

The headlines screamed "Worst Quarter since 2009." The Dow, NASDAQ, and S&P fell 12%, 13%, and 14%, respectively, but the European Stoxx 600 Index fared even worse, falling 17%. In commodities and currencies, it was a mixed quarter. The dollar lost 4.6% to the yen, but it gained 7.7% to the euro. Silver fell 13.7%, but gold rose 7.6%. The benchmark 10-year Treasury bond yield fell to 1.929%, less than the yield on the S&P 500. Overall, the third quarter was disappointing, but earnings announcement season begins soon. Wall Street ignored great second-quarter earnings, but it can't ignore positive sales and earnings forever. Earnings are in a bull market, so we should see a positive final quarter.

Germany "Rescues" Greece, while Demanding Austerity in Italy and Spain

So far, 2011 has unfolded like a crash course in Ancient History. First, the Mubarak Dynasty in Egypt fell, then the civilization of Greece collapsed. Now, the Huns from Germany threaten the Roman Empire.

Most analysts have already priced a collapse of Greek sovereign debt into the price of the euro and European stocks. But Greece is a relatively small economy. Italy is a different story. European banks are loaded with Italian debt, so European stock markets will remain very sensitive to the fate of Italy.

The good news is that German Chancellor Angela Merkel's ruling coalition overwhelmingly voted in favor of a bill to boost the European Financial Stability Facility, effectively forestalling the sovereign debt crisis for now. At home, German aid to Greece is not politically popular, but the whole idea behind the creation of the euro in the 1990s came from Germany, which placed severe budget constraints on member nations. That means Germany will continue to help those countries that pledge austerity and discipline.

Germany's hard line on Greek austerity is likely an object lesson to the larger eurozone laggards, such as Italy, Spain, and even France. When I spoke at an institutional conference in Kansas City last week, I heard from a Putman bond expert, Michael Atkin, who said that Germany is trying to get undisciplined countries in the eurozone to "feel the pain," so that they will get their act together. He said that Germany is trying to make Greece an example of what austerity looks like, so that Spain and the other eurozone countries see the consequences of reckless spending and not follow Greece into the abyss of endless debt.

My own view is that China is the emerging economic powerhouse in the global economy, bringing all of Asia along in its wake. What happens in Europe has minimal impact on stronger economies, like China. Therefore, it is time for Europe to wake up and realize that it is no longer the center of the universe.

The Federal Reserve Board Launches a "Road Show" for "Operation Twist"

Speaking of being fiscally undisciplined, the Fed hit the road last week to defend its $400 billion "Operation Twist," its clever interest-rate manipulation strategy that unintentionally "snapped" our financial markets – sinking stocks and key commodities like gold and silver after it was announced at the Fed's latest Federal Open Market Committee (FOMC) meeting. Here's a taste of the Fed's road show:

1. Last Monday, Fed Governor Sarah Bloom Raskin said that the FOMC's actions were "completely appropriate," given the Fed's mandate to pursue both price stability and maximize employment.
2. On Tuesday, in Jacksonville, Florida, Atlanta Fed President Dennis Lockhart said that the Fed's latest moves were "a measured, incremental attempt to add more support to the recovery. It's not a fix for everything that ails the economy," he said, "but it should help."
3. On Wednesday, Boston Fed President Eric Rosengren spoke in Stockholm, Sweden telling Europeans that the move was necessary, since housing has been a major drag on our economy.
4. Also on Wednesday, in Cleveland, Fed Chairman Ben Bernanke echoed Rosengren's words when he said that the

weak labor market is “a national crisis” that requires attention from the White House and Congress. He called for policies to “find work, train for work and retain job skills.”

This flurry of comments by Fed officials was meant to stem the criticism of the Fed’s latest actions and show support for Chairman Bernanke, who is under increasing fire for promoting easy monetary policies.

Meanwhile, not all of the Fed Governors spoke from the same playbook. Dissenters on the FOMC, like Dallas Fed President Richard Fisher, argued that the Fed’s zero-interest rate policy (ZIRP) has not been effective, since banks continue to curtail lending. Specifically, Fisher said in Dallas on Tuesday that “Until our fiscal authorities get their act together, further monetary accommodation, be it in the form of quantitative easing or performing jujitsu on the yield curve through efforts such as Operation Twist, will represent nothing more than pushing on a string.” Ouch! At least Chairman Bernanke lets other FOMC members speak their minds! Under former Chairman Alan Greenspan, such dissension was not allowed.

Stat of the Week: Second-Quarter GDP Revised Up to 1.3%

Last week, the market rose on Monday, Tuesday, and Thursday. Perhaps that was related to the positive economic news released on those days. On Thursday, the Commerce Department issued its final reading on the second-quarter GDP at 1.3%, up from its previous estimate of 1% and higher than expectations. Stronger consumer spending and construction spending were largely responsible for the upward revision.

Also on Thursday, the Commerce Department reported that consumer spending rose 0.2% in August, despite personal income falling 0.1%. The savings rate declined to 4.5% in August, down from 4.7% in July. The fact that consumers are spending is encouraging. Consumers won’t remain depressed forever. Since consumer spending represents 70% of GDP growth, we need consumers to keep buying.

The other good news released on Thursday was a surprisingly rapid decline in weekly jobless claims, falling 37,000 to 391,000, the lowest level since early April. The rapid decline may be due to technical factors in seasonal adjustments, so we’ll have to wait for Wednesday’s monthly ADP report, Thursday’s weekly jobless claims figure, and Friday’s monthly payroll report for confirmation of this welcome trend.

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