Confidence and What Comes With It

***e*Research Corporation** is pleased to provide a weekly commentary, authored by Tom McClellan, entitled "The McClellan Chart-In-Focus", which is a free technical analysis article published each week.

In this article, Mr. McClellan looks at consumer confidence and the unemployment rate.

The article is reproduced below, beginning on the next page, or you can use this link to go to the article directly:

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Bob Weir, CFA
Director of Research

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The McClellan Chart-In-Focus

by Tom McClellan (bio at end)

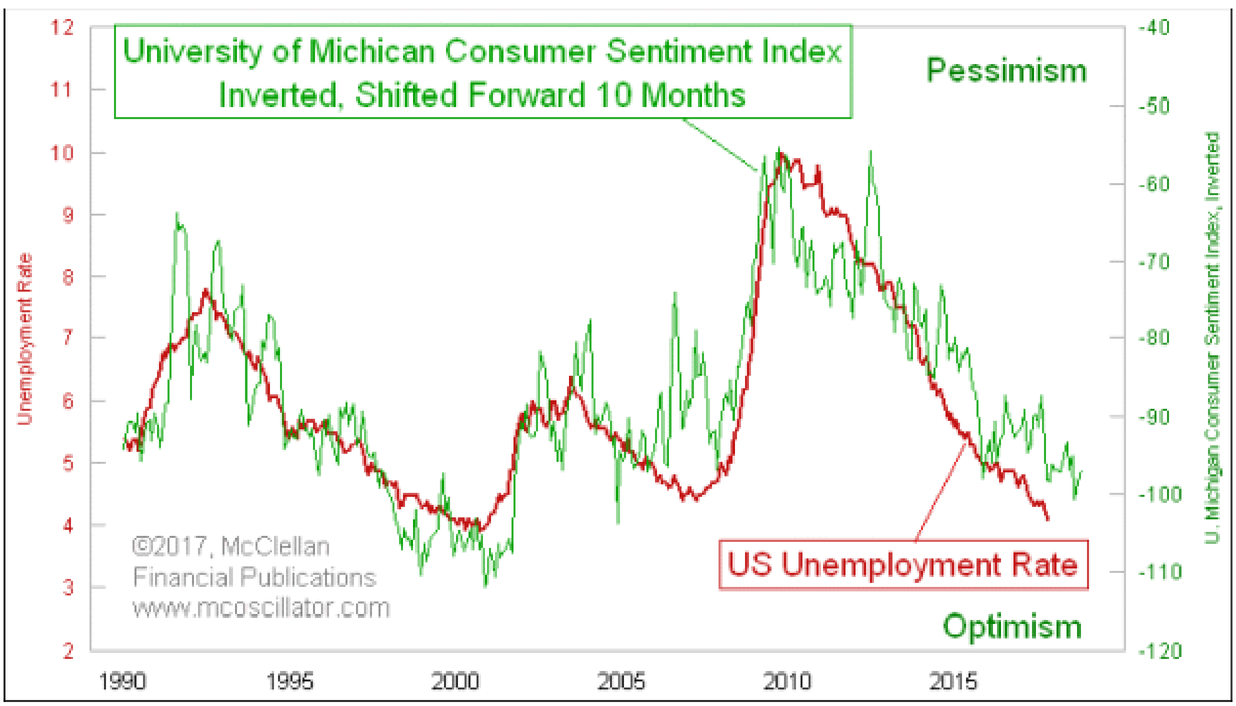
Confidence and What Comes With It

There is a strong positive feedback mechanism involving consumer sentiment and the economy. As conditions get better, people get more confident, which causes them to spend more, so companies hire more, which makes people more confident….

That all works until it doesn't, and then the positive feedback goes the other way, making people get less confident as they see the economy slowing, making them spend less money, which causes layoffs, which makes people less confident….

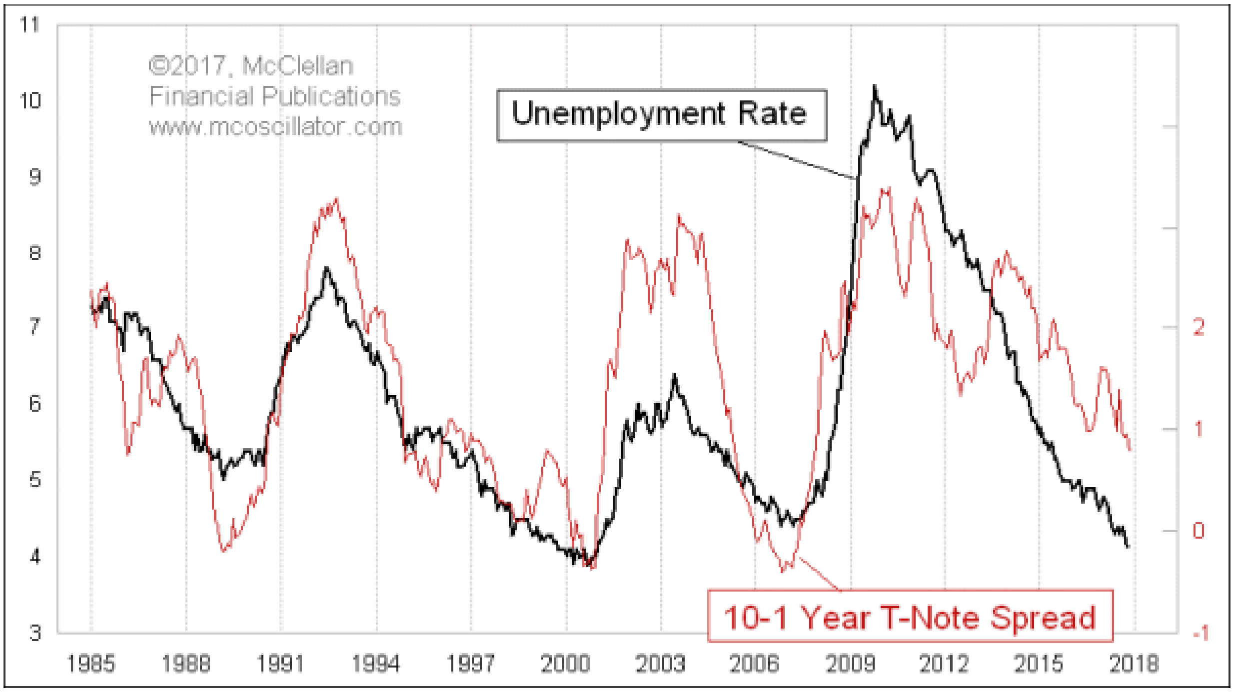
The University of Michigan' Survey of Consumers Index of Consumer Sentiment hit 100.7 in October 2017, its highest reading since January 2004. It has backed off just a little bit since that October reading, but is still at a very high level, showing that consumers are feeling pretty confident.

This week's chart, below, shows the relationship of that University of Michigan number and the U-3 unemployment rate. There is an interesting lag in the unemployment numbers, and that is highlighted with the 10-month time offset employed in the chart below. I want to emphasize that the consumer sentiment data plot is inverted in that chart, so that we can better see the correlation to unemployment.



The falling unemployment rate has just been following the improvement in the University of Michigan consumer sentiment data. And because there is a 10-month lag, we can expect to see continued low numbers for the unemployment rate for the next 10 months or so. At the point when we see consumer sentiment start to deteriorate, then we can look ahead to when that change starts to show up in the economic numbers.

Low and falling unemployment rates have another interesting correlation, as seen in the next chart.

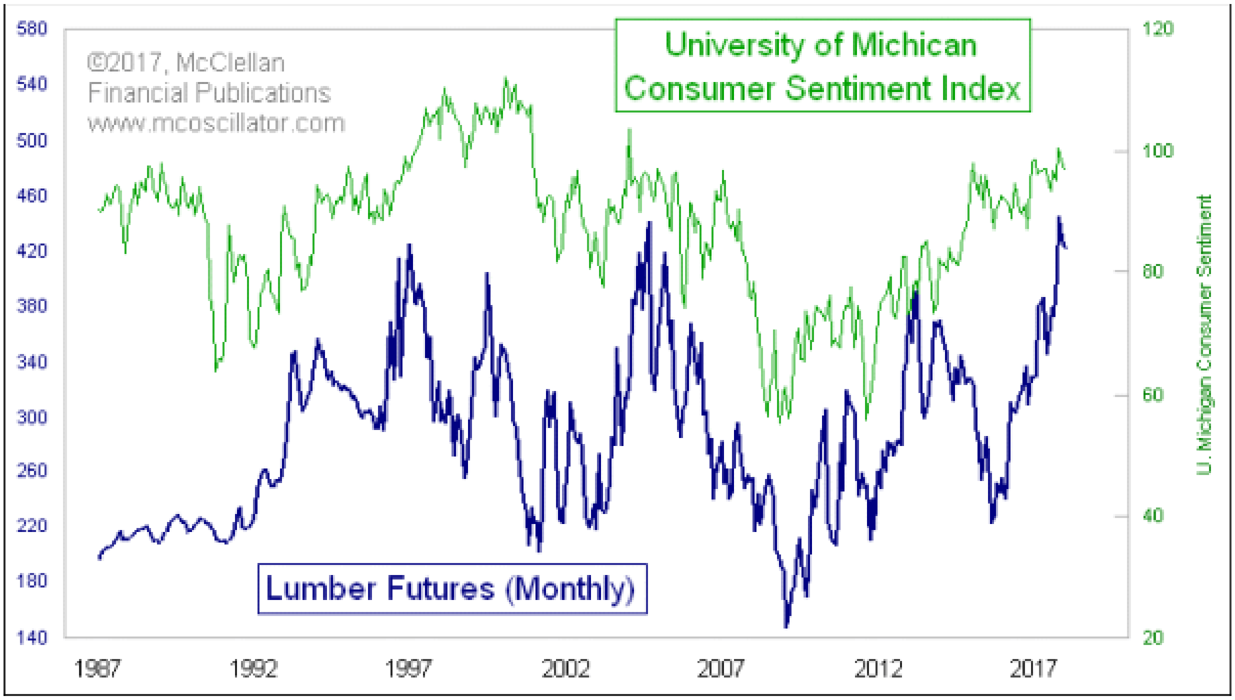


Many analysts are worried about the yield curve, and already proclaimed that it is about to invert and we are going to have a recession, and the Fed is clueless, and we are all going to die, I tell you!!!!

Actually, it still has a bit of distance yet to go before it actually inverts, and recession typically starts months after the inversion actually happens. So there is still some time.

Remember that the University of Michigan sentiment data give us a 10-month leading indication, and they are not showing anything troubling yet. That could change but, for now, it is a good message that things are not really about to drive off a cliff.

So, what is it that can tell us where the consumer sentiment data are heading? I have an interesting answer, in the final chart:



It turns out that consumer sentiment is well correlated with the movements of lumber futures prices. This one at least makes some sense, as lumber demand varies with demand for new housing. And there is no greater expression of an individual consumer's confidence about the future of the economy than his purchase of a new home. That greater housing demand drives up prices, and produces what you see here.

Lumber futures prices recently jumped to an all-time price high, fueled in part by the hurricane cleanup efforts in Texas and Florida. The hurricane damage did not create that trend, but it may have pushed it a little farther than it otherwise would have gone. So far, lumber has not retreated much, and neither has consumer sentiment. We should see both of those give up and head downward before we start to see changes in the unemployment rate.

Tom McClellan

Editor, The McClellan Market Report

BW: Information on Tom McClellan and *The McClellan Market Report* and *The Daily Edition* follows on the next page.

ABOUT THE AUTHOR

Tom McClellan

Tom McClellan has done extensive analytical spreadsheet development for the stock and commodities markets, including the synthesizing of the four-year Presidential Cycle Pattern. He has fine-tuned the rules for inter-relationships between financial markets to provide leading indications for important market and economic data.

Tom is a graduate of the U.S. Military Academy at West Point, where he studied aerospace engineering, and he served as an Army helicopter pilot for 11 years. He began his own study of market technical analysis while still in the Army, and discovered ways to expand the use of certain indicators to forecast future market turning points.

Tom views the movements of prices in the financial market through the eyes of an engineer, which allows him to focus on what the data really say rather than interpreting events according to the same "conventional wisdom" used by other analysts.

In 1993, he left the Army to join his father in pursuing a new career doing this type of analysis. Tom and his Father spent the next two years refining their analysis techniques and laying groundwork.

In April 1995 they launched their newsletter, The McClellan Market Report, an 8-page report covering the stock, bond, and gold markets, which is published twice a month. They utilize the unique indicators they have developed to present their view of the market's structure as well as their forecasts for future trend direction and the timing of turning points.

A Daily Edition was added in February 1998 to give subscribers daily updates on their indicators and also provide market position indications for stocks, bonds, and gold. Their subscribers range from individual investors to professional fund managers. Tom serves as editor of both publications, and runs the newsletter business from its location in Lakewood, WA.

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