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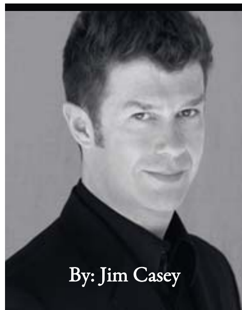
# Sex Sells... And So Does Fear




03.30.2010 | Household confidence remains low, despite evidence that the economy has been growing for three quarters. Perceptions do not appear aligned with the economic outlook.

News accounts remain quite mixed, with the usual emphasis on negative interpretations of the data, even when it is positive, which contributes to that sense of concern. While all 50+ participants in the Blue Chip Survey forecast economic growth over the next year, households continue to pour cash into bond funds and eschew stock funds. This is particularly troublesome because most economists and even the general public expect interest rates to rise over the next few years. Despite the risk of losses in bonds, investors still find that prospect less worrisome than buying equities. As usual, they are likely to re-enter the equity market only after they become more confident by further gains in the market. As usual, they buy at tops and sell at bottoms.

Negative outlooks are given too much credibility and attention. For example, one analyst forecasts that U.S. inflation will be between 10% and 20% in ten years. Such a forecast is amusing mostly because economists have difficulty forecasting more than six months or a year into the future, so any forecast going out 10 years should have little credibility. There are as many fearful forecasts of deflation as inflation. Both can't be correct, but both receive plenty of attention. Some analysts are quoted forecasting that a weak dollar will create imported inflation and scare away foreign buyers of domestic debt, while others suggest a stronger dollar will weaken export and domestic activity. Surely, it can't be correct that both a weaker dollar and a stronger dollar are both bad for the economy.

The experience of the past few years with the credit crisis, the collapse in housing and severe declines in the economy and the stock market render people vulnerable to scary forecasts. This encourages to avoid stocks and to buy bonds, even though most people know that interest rates are unsustainably low right now. Those possible losses in bonds are still perceived as less risky than the risk of loss in equities.

Those perceptions should improve once the economy is hitting on all cylinders, which implies job growth, not just fewer job losses. Significantly, consumer spending is rebounding, despite the still low level of household confidence. Consumer spending has increased over the past several months, coming in better than expected. Car sales have increased even after the expiration of the Cash for Clunkers program and industry reports indicate sales in March are the strongest in quite some time. Airlines are flying at higher occupancy. Hotel registrations have turned positive. Cruise lines have curtailed discounts. Luxury retailers are reporting stronger sales. Forces are clearly building to strengthen the expansion. But there's still one key element, job growth, which is still missing to complete the process and insure that the expansion becomes self-reinforcing. That perception should change once the March payroll report is released in early April. Confidence and finances will both strengthen when March employment shows the solid gain that we anticipate.

As usual, markets tend to move ahead of perceptions. Just as the stock market began to recover in March 2009 before the economic recovery was evident, the market will now continue to recover in anticipation of the resumption of job growth and a self-sustaining expansion.

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