5-Year Recoveries: Reagan, Clinton, Bush, Obama, and "ME" *(SB News-Press)*

(August 26, 2014) Recovery, by definition, is to gain back what was lost. There have been four 2-term presidents in the last 40 years, and each has overseen a 5-year recovery from an economic downturn. The last recession ended in June 2009 – but economists, politicians, market analysts, and the American people have been hard-pressed to think of the last 60 months as a true recovery, because the data is so inconsistent on jobs, Gross Domestic Product, and the stock market. Here are the recent poll numbers on those who ***disapprove*** of President Obama's handling the U.S. economy: CBS-News, 54 percent. Pew Research, 56. Fox News, 57. McClatchy-Marist College, 58. Associated Press, 62. And Gallup reports that "57 percent had little or no confidence in Obama making effective economic decisions". So how does Obama's recovery compare to 5-year recoveries for Reagan, Clinton, and Bush?

During the Reagan recovery of 1983-1988, the Dow Jones Industrials went up 64 percent, while GDP grew 52 percent – from $3.4 trillion to over $5.2 trillion. And by 1988, the unemployment rate was 5.5 percent. The Clinton recovery from 1993-1998, saw the Dow higher by 89 percent, GDP up 38 percent, with unemployment at just 4.5 percent in 1998. And in the Bush post-9/11 recovery (2002-2007), the Dow rebounded 25 percent as GDP expanded 34 percent over those 5 years, with unemployment at 4.6 percent in 2007. The speed of the stock market growth compared to GDP is a simple ratio of M-to-E (market to the economy). The Reagan recovery posted a ME of 1.23 – Clinton's was 2.34 – and it was .73 for Bush. That means stocks were up 1.23 times faster than the economy's growth from 1983-1988; the market grew 2.34 times faster than the economy from 1993-1998; while stock prices grew slower than the economy during 2002-2007. When ME is higher than 2-to-1, it indicates that stock prices are probably being driven by over-optimism (not economic news) – a classic “bubble” effect. The Reagan recovery did enjoy the upswing in the micro-computer era, the Clinton recovery was certainly tied to the dot.com tech-bubble, while the Bush recovery had lower stock market growth compared to a stronger rate of GDP expansion.

The Obama “recovery” started in the summer of 2009 with the Dow at around 8,800. And while unemployment is still over 6 percent (U6 true unemployment at 11 percent), over the last 5 years the Dow peaked in July at 17,138 – up 95 percent, so the stock market presents an image that the economy is recovering. However, GDP is up only 20 percent total in the last five years, from $14.4 trillion to $17.3 trillion. That puts the Obama ME ratio at 4.74 – meaning stock prices are up almost 5 times faster than the economy’s growth. So what’s happening?

Quite frankly, economic news has NOT driven stocks higher. Artificial near-zero interest rates HAVE. But the Fed has publicly stated its bond-buying will end in two months. Without the additional artificial demand from the Fed, prices on U.S. Treasuries will drop in the free market, yields will rise – and all interest rates will go up. Post-WWII historical averages for T-bills, T-notes, and T-bonds have been 5.6 percent overall. Today’s average is 1.6 percent. If interest rates begin to return to true market supply and demand levels sometime after October, this could begin an overall FOUR-point increase in rates. A month ago, the economic news about jobs and GDP indicated the Fed would stay on track to let interest rates move higher. During the 3 weeks that followed, stocks had an 800-point sell-off on the Dow Jones (a 4.6 percent drop in value), while the S+P lost 4 percent. Is this the beginning of a major devaluation in stock values? The stock market has not had a 10 percent correction in almost 3 years. You'd have to go back to 1990-1997 or 2003-2007 to find trading periods where the S+P 500 went longer without a 10 percent pull-back. If this is the beginning of a correction, the Dow needs to drop another 1,200 points to 15,400 – and the S+P has to fall 160 points to under 1,790. Consider these examples.

For a public company with $100M in debt, a one-point rate increase equates to $1M of an additional interest paid to banks, bondholders, and other creditors, and this reduces earnings. Every stock market analyst can then calculate how much earnings will drop for every one-point increase in interest rates. The same is true for consumer spending. A one-point increase in auto loan, home mortgage, and credit card interest creates a proportionate drop in funds available for other purchases. One point higher on a $250,000 30-year mortgage increases the monthly payment by $150 – that's $1,800 for the year. Multiply these impacts by thousands of firms and millions of households, and you can easily see the negative effect a "point" can have on stock prices or the housing market. And don't forget the nation's nearly $18 trillion in debt. Each one-point increase in rates means an additional $180 billion in interest to pay – eating up another 5 percent of total federal spending. But what if these ONE-point examples were hit by that full FOUR-point rate increase? That firm would owe $4M in additional interest and its earnings would drop by over $2.6M – and the stock price would HAVE to drop accordingly. That home mortgage would be $600 higher per month – $7,200 more per year to afford that house! And Treasury interest would increase by $720 billion – climbing to about one-fifth of the entire federal budget.

The concern now is that the last five years have not been a recovery by any means, and stocks have enjoyed higher earnings due to artificially low rates. For 'ME', there's no substantive economic news to support the market growing at almost 5 times faster than GDP. Higher interest rates are finally coming, and the jobs and GDP data remain inconsistent. Can corporate earnings maintain continued growth in stock prices? Or is that 10 percent correction finally due?