

DJC

THE DAILY JOURNAL OF COMMERCE, PORTLAND, OREGON



William Rutherford

Central Bankers in the spotlight

Published September 10, 2012

Since the overall market, as measured by Standard & Poor's, is up over 13 percent for the year, over 10 percent since May lows and more than 2 percent in August alone, cautious optimism has emerged.

However, political risk hangs so heavily over markets globally, it is hard to be anything but worried. Furthermore, September is a notoriously difficult month for stocks. Expect more turbulence.

Globally, economies are slowing. Even Germany, which has been the bulwark of the European economy, has slowed as Europe sinks into a recession. In Asia, much uncertainty prevails as China, the key driver there, sees its economy slowing.

In the U.S., signals are mixed. Factory orders are reported stronger than expected. Consumer confidence, as measured by the University of Michigan index, also is surprisingly up.

Durable goods manufacturing is up 9.8 percent year over year, with durable goods sales and orders both up over 14 percent. Factory order backlogs are 14.4 percent. New housing starts are up 29 percent, and new housing building permits are up 29 percent year over year.

The big three automakers mark double-digit sales gains in August year over year. Productivity increases to 2.2 percent up from expected 1.9 percent year over year.

But other measures, such as the purchasing managers' index and the construction index (which includes government construction), show declines in July and August. And a serious drought in the Midwest threatens farmers and farm-related industries.

With the mixed tone, one can be wary of the U.S. economy – especially factoring in the political risk. As the election nears, the outcome is still very much in doubt. At this juncture, President Obama is probably still the odds-on favorite to retain his job; however, former Massachusetts Gov. Mitt Romney is within striking distance.

Romney has the all-important edge in money. Obama holds the incumbency, normally a powerful weapon. However, since the years of the Obama presidency have been a disappointment to both the right and the left, he should be an easy target.

Romney has thus far failed to take advantage of the deficiency in results. Usually, a candidate gets a "convention bounce" (a lift in the polls) after a national convention; Romney got none.

Two states hold the key to a Romney victory: Ohio and Florida. If he were to win Ohio and lose Florida, he would have a chance to cobble together a victory; but it would be difficult. If he were to win Florida and lose Ohio, he would have a much better chance to win. If he were to win both states, he would likely win the election.

This is why it is so puzzling that he passed up popular politicians in Florida and Ohio to make Rep. Paul Ryan of Wisconsin as his running mate. Sen. Rob Portman in Ohio has an excellent record among Ohio voters and has won difficult elections there. Sen. Marco Rubio of Florida is popular in his state and has the added advantage of being Hispanic at a time when Hispanics are expected to have a large impact on the race. Romney is running a distant second to Obama among Hispanic voters.

Romney also has a deficit among woman voters, and a polarizing Ryan will not help there. Of course, Ryan does energize the Tea Party base of the Republican party as well as the social conservatives; however, he energizes voters both for and against a Romney candidacy. Instead of moving to the center to pick up votes, Romney moved to the right, and passed up opportunities that could have helped in critical swing states.

These decisions by Romney and his election team, plus outrageous comments by Republican Senate candidate Todd Akin of Missouri, cast a cloud over Republican chances in the fall. If the Republicans were to make a clean sweep of Congress and the White House, at least we would have a clear policy. However, if the Republicans were to win the House and lose the Senate and the White House, we may have more of the deadlock we have experienced – and the “fiscal cliff” may become a reality.

A divided government will present serious burdens for the economy. The “fiscal cliff” means that the Bush tax cuts will expire and one trillion dollars in revenues will become sequestered. Economists predict that this outcome will plunge the U.S. into a recession, taking the world with it.

In Europe, the struggle over the salvation of the euro and the eurozone continues, also with a heavy dose of politics in the background. European Central Bank President Mario Draghi has pledged to save the euro, which has already lost a lot in value. But the euro, always a political currency, is at risk.

One or more countries might return to their old currency, and that might be the best outcome. But problems in Spain and Italy wait in the wings, and a solution must be found there too. However, the Germans do not like the options on the table, and there things stand. I do believe that the bones of a deal are there, and it would not take too much for the countries to agree, but Greece may still be on the way out of the eurozone.

These reasons are why Ben Bernanke, in his latest speech in Jackson Hole, outlined a plan to move the U.S. economy forward. He spoke of a “grave” unemployment level, language never before employed by a Federal Reserve chairman.

His plans will not be popular in some quarters. Romney has already pledged to fire Bernanke as one of his first acts. The likely outcome of the Jackson Hole speech will be one or more unconventional acts: extending the period of low interest rates into mid-2014, buying more Treasury bonds and perhaps even mortgages or other alternatives, or a combination.

So, as I stated last month, the burden of economic growth and stability falls upon Central Bankers as politicians fail to provide solutions.

William Rutherford is the founder and president of Portland-based Rutherford Investment Management. Contact him at 888-755-6546 or wrutherford@rutherfordinvestment.com. Information herein is from sources believed to be reliable, but accuracy and completeness cannot be guaranteed. Investment involves risk and may result in losses.