THE TRUTH ABOUT WHY MAIN STREET IS STILL STRUGGLING

Elliott Wave International's unbiased look at the 2009-2013 economic recovery

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US Economic Report

from Elliott Wave International

by Nicole Isaac

When people refer to the "2008 US financial crisis," it seems natural that it would be in the past tense.

Opinions may differ over its exact beginning. Was it the subprime mortgage debacle, the housing market bust or easy, exorbitant credit that led the whole debt-unraveling disaster? All three could claim victory. But few disagree as to when the crisis officially ended. In April 2010, the National Bureau of Economic Research's business cycle dating committee identified June 2009 as the "trough" of the Great Recession. It's set in stone. On the Wall Street Walk of (In)fame, its star has been laid with clearly defined dates, like an epitaph, 2007-9.

Now, it's four years later, but Main Street — as opposed to Wall Street — has yet to reap the benefits of the supposed post-recession recovery. While the pools of institutional money spill over, employment measures lag, returns on savings dwindle, and measures of consumer confidence fade. Forbes magazine points out that this is the "slowest upturn from any economic downturn since World War Two." (Forbes, Oct. 12, 2013)

No matter, say the pundits. They see the tepid pace of economic activity as a positive sign. In a November 4, 2013, interview with the investment website Seeking Alpha, one veteran economist explains: "Our view all along has been that there would be a long, slow healing process from the 2008-9 financial crises."

Slow it is. But there's a deeper problem with how economists view the world, let alone the recovery — *as a group, they are always late to recognize change.* "Conventional economists have a perfect track record of failing to predict economic contractions," wrote Elliott Wave International President Robert Prechter in the first edition of his book *Conquer the Crash* (published 2002).

Here are but a few historical examples where the majority of economists failed to see an impending change of economic direction before it was too late:

- **In the early stages of the Great Depression,** when the DJIA lost 89% from September 1929 to July 1932

  > With the stock market showing a decided rallying tendency, officials professed confidence that the 'worst was over' in connection with the collapse of values on the security exchanges and that businesses would suffer no severe and general depression.
  >
  > —Montreal Gazette, Nov. 15, 1929

- **Right before the Internet 1990's dot.com bubble burst,** sending the global economy into a tailspin, with the NYSE suffering an overall market loss of $9 trillion

  > The US Economy continues to break records. Some analysts believe the US economy has entered a 'new paradigm' where old economic rules no longer apply.
  >
  > —The Guardian, Feb. 3, 2000

- **Right before the S&P 500 Homebuilding Index peaked and the housing bubble burst**

  > There is a new paradigm in real estate in which prices rise indefinitely.
  >
  > —CBS News, March 2005

- **The year that global credit started to implode,** sparking a financial crisis the likes of which the world hadn't known since the Great Depression

  > At a London economic conference, the world's key financial leaders made this pledge: The subprime mortgage crisis is "reasonably well contained." There are no clear signs it's spilling over into other subsets. We see little risk of wider fallout from rising delinquencies and defaults.
  >
  > —Bloomberg, June 27, 2007

Now we see headlines and articles such as this:

Job Growth Slowdown Likely to Reverse
—The Wall Street Journal, April 2013

The US economic outlook is as strong as it has been in more than a decade.
—Time magazine, August 2013

The US Is In Its Strongest Economic Position In 20 Years.
—Bank of America Merrill Lynch, December 2013

Economists' forecasts consistently miss important financial trend changes. The question is, why? The reason is that, as a group, economists linearly extrapolate the future of the economy from past performance. At the bottom, they were afraid. Now they're confidently optimistic.

Conquer the Crash, explained why that is:

> Optimistic beliefs are simply an expression of the underlying social ebullience manifest in the stock market rally …

The faith in recovery we see today is the exuberance of a five-year stock market rally. Investors are even more optimistic than economists. While the overall economy barely grinds ahead in first gear, indicators of Wall Street psychology stand at historic extremes of optimism. This optimism is the only thing holding up nominal stock prices.

In later editions of *Conquer the Crash*, Prechter predicted that the split personality between soaring equities and a slumping economy would have one highly probable ending:

> The great imbalance between sky-high expectations and a decreasingly robust economy will result in contraction.

It happened in 2007 and it's poised to happen again.

In these next sections, we will show just a few indications of how Mr. and Ms. Joe Average are feeling the pinch in crucial areas.

PERSONAL INCOME

For those people who earn the bulk of their income from monthly paychecks, rather than from stock portfolios, the stock market's rally has made little perceptible difference in their economic well-being. One November 6, 2013 news report notes:

> In the second-quarter 2013, corporate profits equaled 12.5% of the US economy, just under a <u>60-year high</u> set two years ago. At the same time, wages and salaries equaled 42.6% of the economy, near <u>a record low</u> set in 2011. The reason for the disparity: the wealthiest 10% of households own about 80% of stocks. (Times Daily)

For the remaining households, the picture of their personal livelihood appears to be going in one direction: <u>down</u>.

- In 1989, the median US household earned $51,681 in current dollars. In 2012, that number was $51,017. Meaning, <u>24 years ago, a middle class American family was making more than a middle class family makes today</u>. (The Washington Post, Sept. 17, 2013)

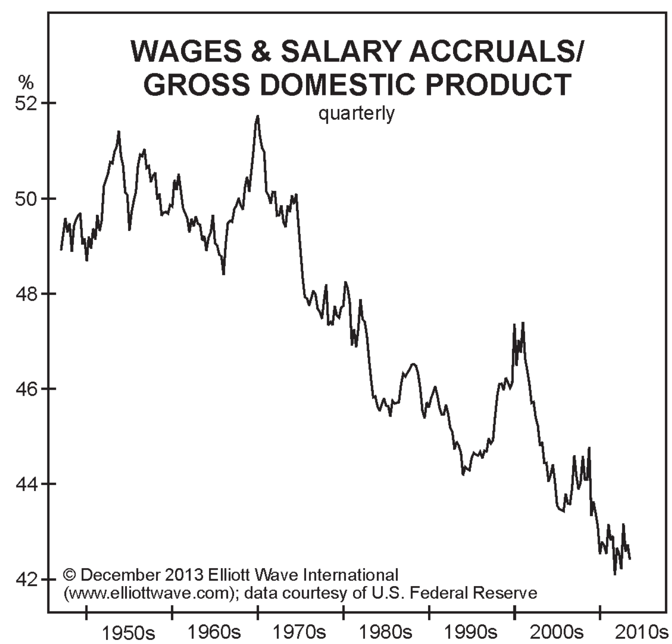

Figure 1

- Wages as a percentage of GDP are also near an <u>all-time low</u> of 42%.

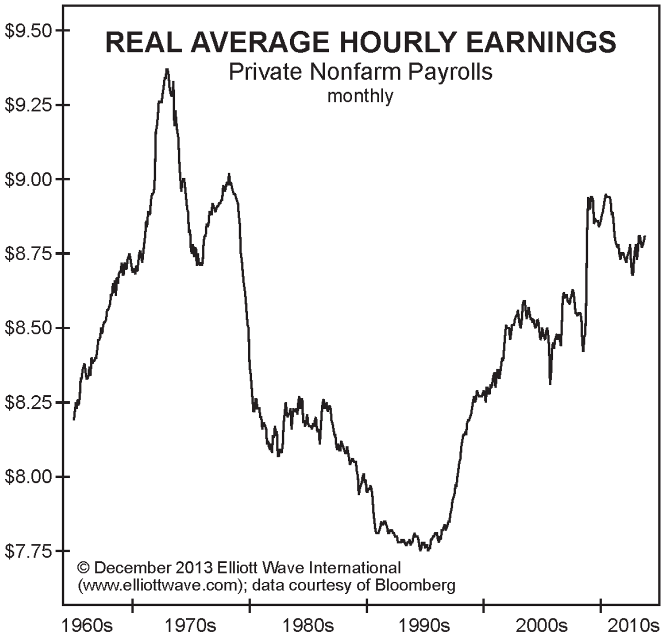

Figure 2

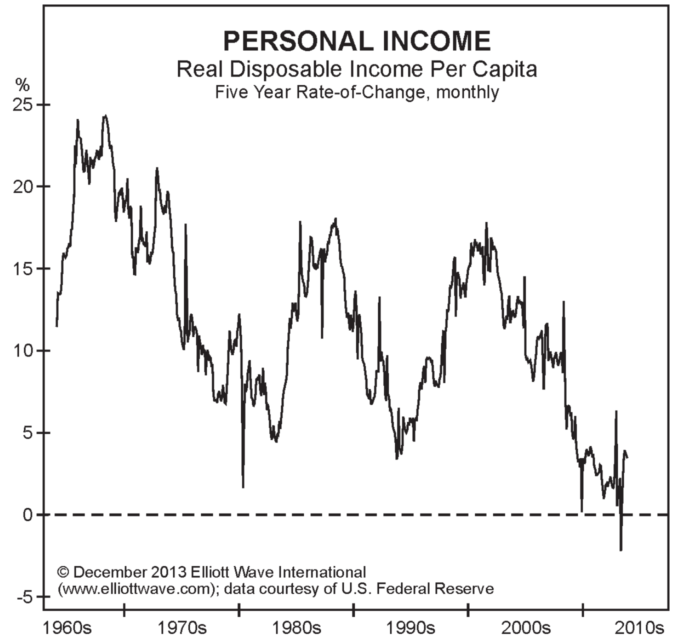

Figure 4

- Real US average hourly earnings made a secondary high in late-2008 and have remained stagnant since, as shown on Figure 2.
- A September Census Bureau report revealed that the number of Americans in poverty stood unchanged at 15% in 2012 (the most recent year of figures), near the peak point in the data's 53 year history going back to 1959. It was also the sixth straight year that the poverty rate failed to improve. (The Washington Post, Sept. 17, 2013)
- A September 28, 2013 CBS News report showed a 38% spike in the number of homeless children since the start of the recession.
- The Basic Access Index, a Gallup Poll gauging the ability of households to afford food, housing, and health care, was 81.5 in October 2013, on par with the all-time low of 81.2 recorded in October 2011. (Gallup.com)
- The five-year rate-of-change in real disposable income recently dropped to a historic low of negative 2%. (See Figure 4.)

Figure 3

Ironically, this sharp decline over the last decade, combined with the rise in the cost of living, has spawned two raging bull markets: itinerant communities and food stamps.

First, a 2013 Housing Predictor report describes "America's New Real Estate Boom: Tent Cities":

> With a massive spike in the number of foreclosures and evictions over the past two years, communities throughout the US have witnessed the sprouting of tent cities — many of them home to once middle-class citizens fallen victim to the economic downturn.

And, second, the use of food stamps is surging. In the January 2012 issue of *The Elliott Wave Theorist*, Bob Prechter foresaw a continued boom in the market for federal subsidies:

> Figure 5 is another among several charts that support the case for depression. As you can see, the number of food-stamp recipients has been soaring. This is another statistic that can't hide behind inflation.

A year and a half later, the Congressional Budget Office reveals that the number of people in the United States receiving benefits from the Supplemental Nutrition Assistance Program (SNAP) is at an all-time record of

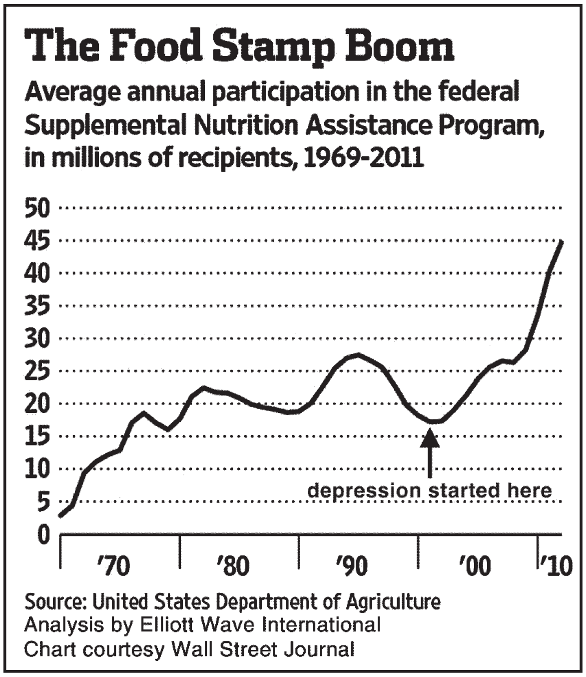

Figure 5 (*source:* The Elliott Wave Theorist, *Jan. 2012*)

more than 47 million. In percentage terms,13.6% of US households received SNAP benefits, up from 8.6% in 2008. (USA Today, Sept. 20, 2013)

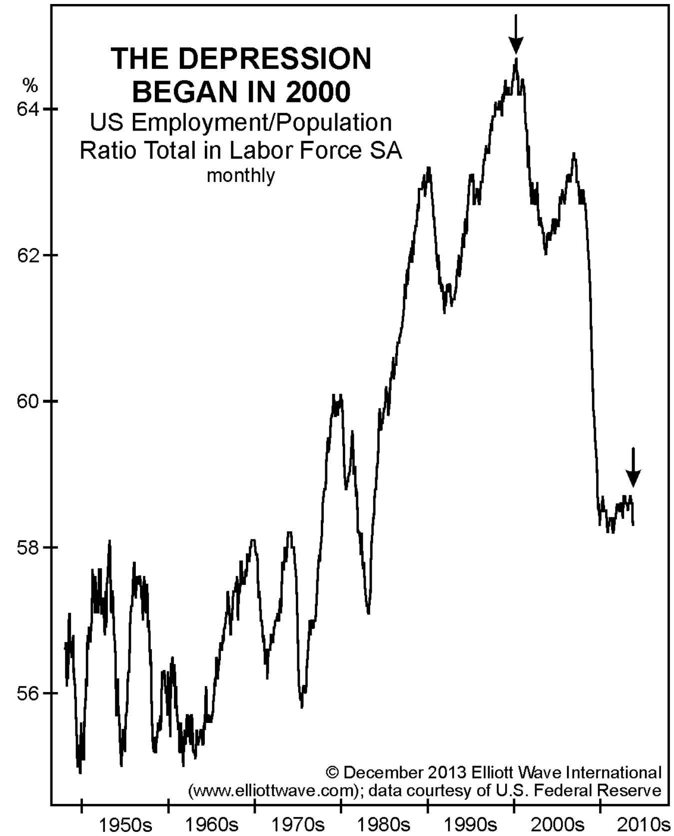

Figure 6

EMPLOYMENT

In 2009, pundits who recognized a low in the economy predicted a big surge in jobs:

> US Unemployment May Finally Have Hit Bottom
> —Wall Street Nation, May 9, 2009

> The deceleration in firings, coupled with stabilization in housing and manufacturing, signal the recession is easing. The worst is over for the job market and the economy.
> —Bloomberg, June 5, 2009

Around the same time, EWI's analysts were predicting the opposite: The jobs crisis was not going away; it was still very much in force. The following quotes captured our view:

> Layoffs and wage cuts that will fuel the fire are sweeping the planet.
> —*The Elliott Wave Financial Forecast,* March 2009

> The long-term trend in the economy is down. Certain ratios tell the true story: the US Employment/Population Ratio Total in Labor Force SA monthly.
> —*The Elliott Wave Theorist,* September 2009

Flash ahead four years to today. An updated version of the same chart from Bob Prechter's September 2009 *Theorist* shows how the jobs/population ratio has remained weak and is falling once again. (See Figure 6.)

Kick the can farther down the road, and the numbers grow ever bleaker. Yes, the unemployment rate fell in November to 7.0%, its lowest level in nearly five years. But that's because only 63% of Americans now participate in the workforce, *the lowest participation rate in 35 years*, since 1978. (See Figure 7.) Yet these numbers do not sway the "experts," who are steadfastly expressing the optimism that goes along with an elevated stock market. As a Business Insider article states: "The drop in the Labor Force Participation Rate should be seen as a temporary symptom of the shutdown and not a major shift in the Labor market." (Business Insider, Nov. 8, 2013)

The truth is, a negative shift has been under way in the labor market for quite some time:

- The gap in employment rates between America's highest- and lowest-income families is at the widest level since tracking began a decade ago. (Associated Press, Sept. 16, 2013)

Figure 7

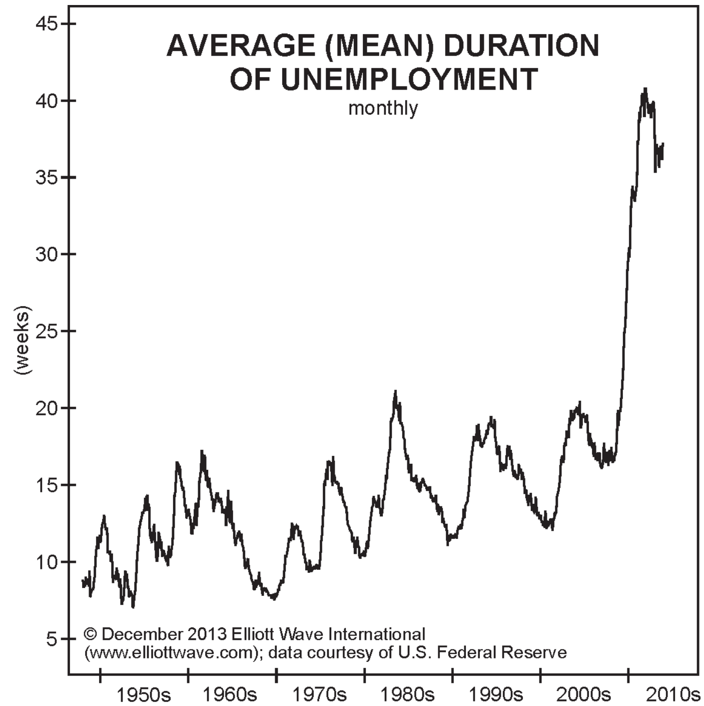

Figure 8

- The factory workforce through August 2013 is 13% smaller than when the US fell into recession in 2007. (Businessweek, Sept. 6, 2013)
- 77% of new jobs created since January 1, 2013 have been part-time gigs. (Mensnewsdaily.com, Sept. 12, 2013)
- The second-largest employer in the United States is Kelly Services, a temp agency. (Washington Examiner, July 8, 2013)
- Oregon panhandlers outside Wal-Mart can make $300 a day. Inside, it takes a Wal-Mart clerk a week to make that much. (KOMO News, Oct. 30, 2013)

The full-scale abatement of employment opportunities has resulted in a dual phenomenon among job-seeking Americans:

First, a new workforce has emerged in which "bodies double as cash machines." (Bloomberg, Oct. 15, 2013). Simply put, the under-worked and under-paid have resorted to selling their own hair, breast milk, even their internal organs and ova (egg donation) in order to make ends meet.

And second, the emergence of a "boomerang generation," in which grown adults return home to live with their parents. A Pew Research Center study found that 36% of young adults aged 18 to 31 now live with Mom and Dad, the highest share in at least four decades. (CNN, Oct. 1, 2013)

CONSUMER SPENDING

It's a widely accepted axiom that there can be no economic recovery without a major pickup in consumer spending. Yet consumers maxed out their spending ability nearly five years ago. It's a burgeoning trend that EWI analysts recognized early. Here, *The Elliott Wave Financial Forecast* (April 2009) sets up the scene:

> At this point, the government is doing everything in its power to get people to borrow. ... This chart [see pg. 6] shows that in the fourth quarter of 2008, total household credit market debt declined for the first time in more than 50 years. ... It's a graphic illustration of the new conservatism that was predicted in *Conquer the Crash*. In a billion different ways, the trend is conspiring to thwart the governments bid.

EWFF (August 2009) provided a similarl comment about the ratio of US Consumer Debt to Disposable Personal Income:

> Obviously, the US consumer is not participating in the post-peak debt binge. … psychology has completely reversed, because now, even as stocks rally, consumers are trimming their exposure at a quickening rate.

In the end, an economic recovery without consumer spending is like a plane experiencing engine failure. It can coast on autopilot for a while, but not long enough to escape the inevitable crash landing. As one news source reports: "In the 20 years before the recession, consumer spending grew an average of 3.4% a year. Since 2010, it's risen just 2.2%" (Times Daily, Nov. 6, 2013)

There are no more illusions. The critical preconditions for a resumed *economic contraction* are in place.

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Personal income, employment and consumer spending — these are not expendable aspects of economic growth; they are its lifeblood. The charts in this report show that instead of a strong and expanding economy, the US economic engine is sputtering. The latest weak "recovery" has been unable to overcome the heavy weight of the long-term downtrend that started at the beginning of the last decade. Our forecast is that the economy is now set to roll over even harder.

But this is not a story of defeat. It's about conquering the coming crash through preparation, patience and pro-action. Here's how Robert Prechter states it from the pages of his New York Times bestseller:

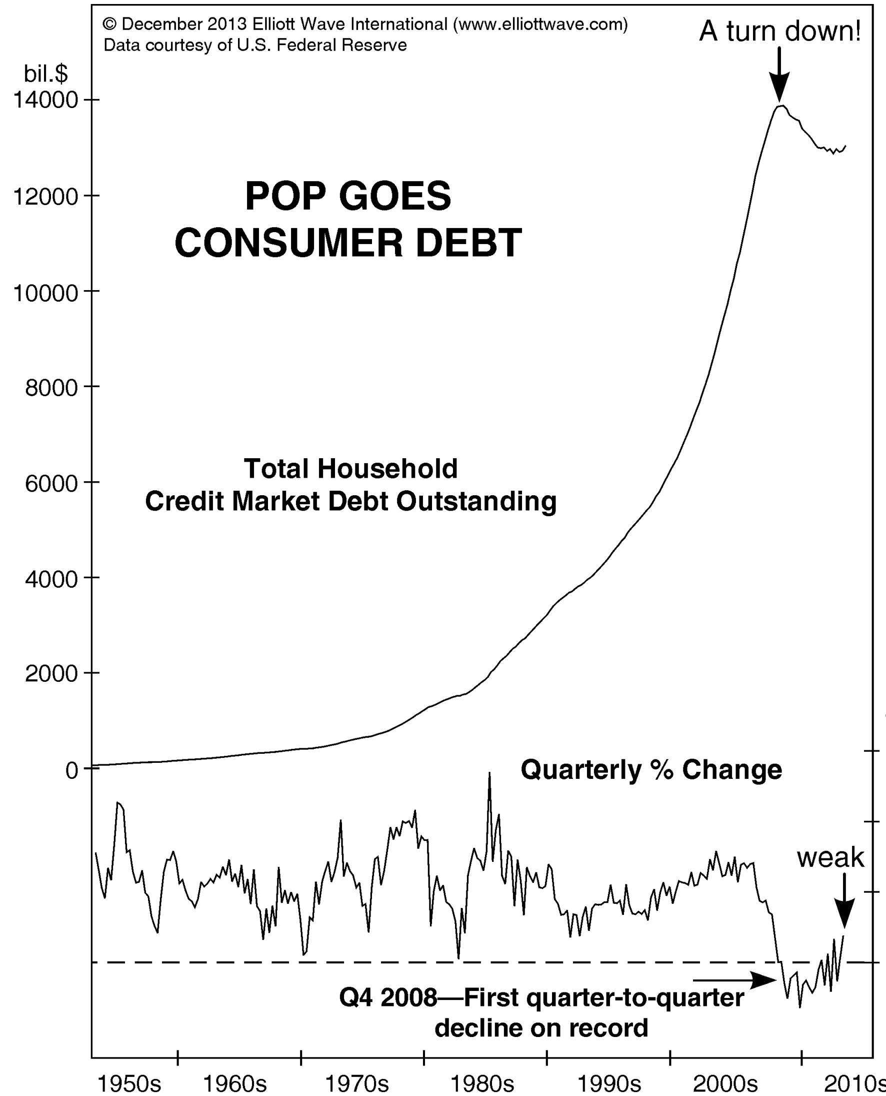

Figure 9

> Before you can take steps to protect yourself against a deflationary crash and depression, you have to understand what they are, believe that they are possible, and then agree that they are likely.
>
> —*Conquer the Crash,* 2002

In this report, we show clear and compelling evidence of these unfolding economic trends. For more in-depth analysis, look to Prechter's third edition of *Conquer the Crash* and EWI's regularly published newsletters: *The Elliott Wave Theorist, The Elliott Wave Financial Forecast* and *The Financial Forecast Short Term Update.*

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