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Improving Economic Indicators Fuel a January Market Surge

By Louis Navellier

The S&P 500 rose another 1% last week (and 4.2% so far for the New Year), due largely to positive economic news, including surging new housing starts and falling jobless claims. In addition, inflation is seemingly contained, and corporate revenues are coming in better-than-expected. The market's biggest worry – i.e., the U.S. debt ceiling debate – might be postponed as the House of Representatives is seeking to pass a three-month extension, buying more time for a debate over the level of government spending.

Stat of the Week: Inflation is nearly Non-Existent…or so they Say

Last Tuesday, the Labor Department reported that the Producer Price Index (PPI) fell 0.2% in December, the third straight monthly decline. The core PPI, excluding food and energy, rose just 0.1%. Over the past 12 months, the PPI is up just 1.3%. On Wednesday, the Labor Department announced that the Consumer Price Index (CPI) was unchanged in December, while the core CPI rose 0.1%. The CPI has risen 1.7% in the past year and an average 1.9% per year since 2007, so inflation seems under control.

But I am skeptical of these numbers. In the last few years, many commodities have doubled in price. Since President Obama's first Inauguration in 2009, gold, silver, and oil have more than doubled. Even with gasoline prices down in the last few months, gas still costs almost twice what it did in 2009.

The government's inflation statistics tend to ignore the real needs most Americans must face in their household budgets. In the energy sector, natural gas prices rose 15% last year, and in the wholesale food commodity markets, we've seen 9% or greater gains in wheat, cheese, oats, and chicken during 2012.

As the dollar weakens further – due to the Fed's loose-money policies and trillion-dollar annual budget deficits – commodities should continue to rise, since most commodities are priced in U.S. dollars.

If the Fed prints new money and the banks don't lend it out, then that liquidity most go somewhere. Much of it is buried in the bond-market, but stocks are catching up. Last year, NASDAQ rose 15.9% and the Russell 2000 rose 14.6%, so there are some positive side effects of monetary inflation for stock investors.

Meanwhile, the Fed Keeps Rates Low and Dismisses Any Inflation Fears

Fed Chairman Ben Bernanke told his audience at the University of Michigan last week that monetary inflation need not lead to price inflation. Specifically, he said, "I don't believe significant inflation is going to be the result" of the Fed's latest round of quantitative easing (QE3). But the problem with unlimited quantitative easing is that – like a drug addiction – it loses its effectiveness after a while.

Last Wednesday, Dallas Fed President Richard Fisher said the Fed's latest quantitative easing scheme is "having a lesser impact as we go through time," especially since most big banks are not lending that money out. Instead, Fisher says, most big banks are preoccupied with rebuilding their balance sheets.

The Fed's 0% interest rate policy has now been in place for almost four years and is officially scheduled to continue well into 2015. Unofficially, it will likely continue "forever," since the real reason that the Fed cannot raise interest rates is that it will "blow up" the cost of the federal government by raising the cost of the service on our $16 trillion in debt. A low average rate of 1% on Treasury securities costs $160 billion per year, but a ballooning of these rates to a 5% average would cost the Treasury $800 billion per year, rising $50 billion per year (5% of each year's new trillion-dollars of borrowed money).

Therefore, the Fed has no choice other than to keep interest rates near 0%, while continuing to buy $85 billion per month in securities. This will keep yields low and could force yield-hungry investors back to the stock market.

With Ben Bernanke at the helm of the Federal Reserve and Jack Lew likely to become our next Secretary of the Treasury, I see four more years of monetary easing and trillion-dollar annual deficits, resulting in a further decline in the U.S. dollar, likely giving an extra boost to commodities and blue-chip multi-nationals.

Most Major Economic Indicators are Still Sending Positive Signals

The rest of the economic news last week was largely positive:

On Tuesday, the Commerce Department reported that December retail sales rose 0.5%, the strongest monthly retail sales report since September and much better than economists' consensus of 0.2%. Also, October and November's retail sales were revised slightly higher. Sales at gas stations declined 0.8% due to lower gas prices, but that's good news. Taking out gasoline sales, **overall retail sales rose 0.8% in December**, a positive indicator for improved GDP growth.

On Wednesday, the Fed reported that December industrial production rose 0.3% and factory output rose 0.8%. The Fed's Beige Book was more downbeat, with three of the 12 Fed districts reporting a decline in factory activity last month, but since utility production fell sharply, due to unseasonably warm weather, it depressed the overall industrial production totals. Even with lower utility costs, **fourth quarter industrial production was up 1%**, which should boost GDP.

On Thursday, the Commerce Department reported that **December housing starts surged 12.1%**, the highest growth rate since June 2008. Regionally, the Midwest led the way, with 24.7% growth, followed by the Northeast (21.4%), West (18.7%), and South (3.8%). Single family starts rose 8.1%, while multi-family starts rose 20.3%. The other good news released on Thursday was that **jobless claims fell by a whopping 37,000** to 335,000 and the four-week moving average declined by 6,750 to 359,250. Overall, this is great news, indicative of a strong pickup in hiring.

Friday brought the only negative news of the week, when the University of Michigan/Reuters's preliminary January **consumer sentiment index slipped to 71.3**, down from 72.9 in December. Concerns over the debt ceiling were cited. I suspect the real reason for the drop is the 2% reduction in paychecks due to higher payroll taxes.

Outside the U.S., we see mixed indicators: The euro-zone's industrial output declined 3.7% in November, the biggest monthly decline in three years, while China's exports and imports surged in December, so the overall global recovery is intact, and the stock market should be able to ignore any drag from Europe.

Marketmail gets updated on Fridays and whenever the DOW closes up or down 300 points or more.

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