"FUD" . . . FEAR, UNCERTAINTY & DOUBT STRIKES – AGAIN
Elmer - It's Time to Hunt "Beests"


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Caution: It's a risky world we live in. My opinions are based on information believed to be reliable but hey, I could be wrong. When investing, try to use good judgment and don't hesitate to seek professional assistance. Remember to set limits and have a plan. . . Good Luck!

Some thoughts to consider:

Today's market action is text book "FUD". There has been indiscriminate selling. For every "sell" there is a "BUY". The sellers are experiencing pain – literally – as their brains are firing up when they realize losses. The buyers are experiencing pleasure . . . they are in a place where they can be the most assured they are getting a good deal. Insiders have been reported to be buying aggressively in recent days.

Patient and opportunistic BUYS on days of panic over the next couple of months as the market builds a base will become the stuff of legend. These SELLS will be thought of with remorse.

Poor Elmer is confused . . . he doesn't know if he should run away like the Wildebeests or if he should join the lions and bag a trophy "beest". He should take his time, stalk the best "beests" and take the high probability shot.

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The following bullet points are associated with recent blog posts at www.aberdeeninvestment.com. I have included each post and the associated charts on the following pages.

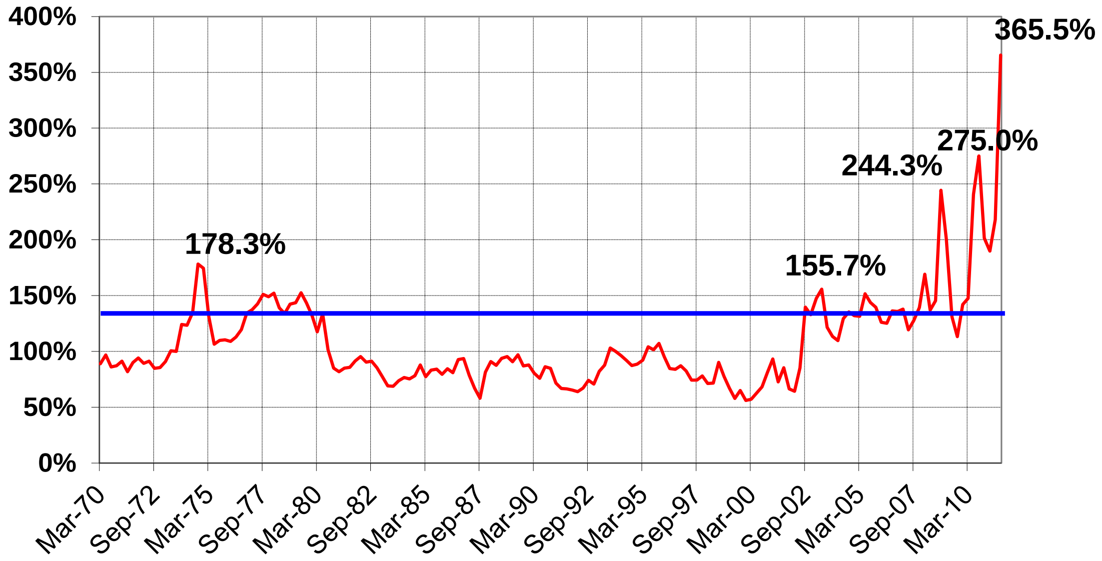
- **We are experiencing the widest spread in the S&P 500 earnings yield and the 10 year Treasury rate in modern market history.**
- **Banks have too much cash and too few loans. It will be hard to have a recession when there aren't a lot of loans to charge off.**
- **There is a record $21.2 TRILLION in US retirement accounts, cash and bank accounts and retail money market funds.**

- **Over $52 billion was stuffed into money market funds last week – the most since the panic of 2008/2009.**
- **Disposable Personal Income (DPI) and Personal Consumption Expenditures (PCE) are both still on the rise.**
- **There is over 10 months of personal consumption expenditures (PCE) sitting in cash and money market funds – this is the most in over 20 years.**
- **Despite the sentiment and cash hoarding there is still forward momentum in the economy as illustrated in industrial production.**
- **Retail sales show the consumer wasn't panicking in July . . . so says Brian Wesbury at First Trust . . . While the chart is pointing up, we must admit to the absolute collapse in consumer sentiment since the retail sales numbers were compiled.**
- **The weak consumer sentiment and panicked hoarding of cash has set the stage for weaker employment in August and September and possibly well into Q4.**
- **M2 Update – When this much cash gets sucked out of the economy we must expect a slowdown – not necessarily a recession, but certainly a slowdown.**
- **The recent hoarding of cash in M2 portends a slowdown in corporate profit growth.**

We are experiencing the widest spread in the S&P 500 earnings yield and the 10 year Treasury rate in modern market history.

Panicked investors have bid up the price of Treasury bonds and sold down the price of equities to such a degree that **the earnings yield on equities (the reciprocal of the P/E) is now 365% greater than the yield on the 10 year Treasury**! This is simply unprecedented in the lives of anyone active in the market today. The earnings yield on the S&P 500 is now 7.9% compared to the yield on the 10 yr. Treasury of 2.17**%. Anyone who believes in regression to the mean should be wildly bullish.** The mean spread is 107.8%. The implication is the Treasury rate must either go up to 7.3% or the earnings yield must fall to 2.3%. An earnings yield of 2.3% would equal a P/E ratio of 44X. Meeting in the middle suggests a P/E ratio close to 20X vs. today's P/E ratio of 12.6X. Either way – **something has to give!** *Jeb Terry, Sr. Aug 17, 2011*

S&P 500 Earnings Yield / 10 Year US Treasury
Nominal Spread as Percent of the 10 Year Treas.
1970 to Present



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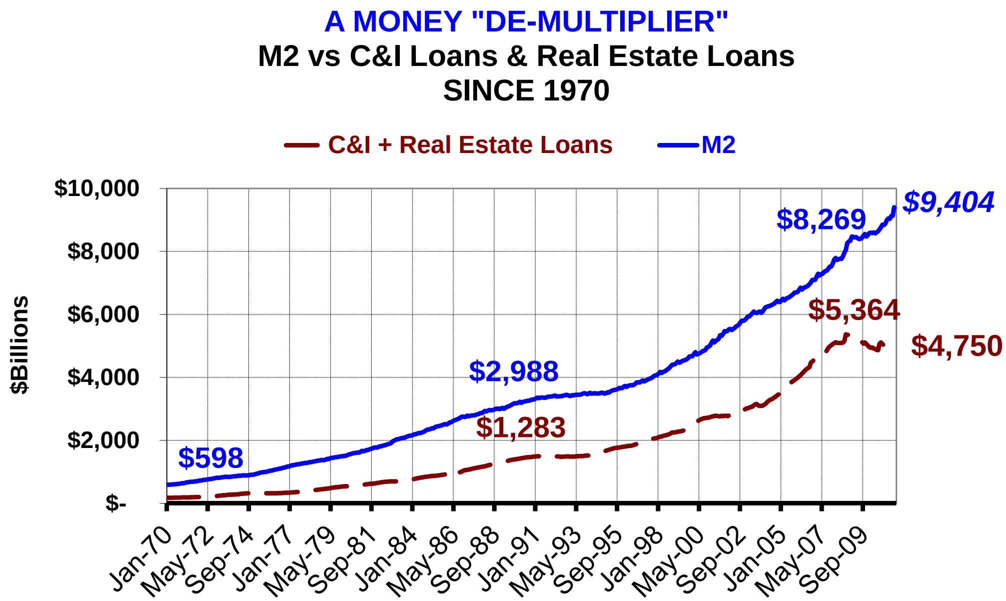
Banks have too much cash and too few loans. It will be hard to have a recession when there aren't a lot of loans to charge off.

Part of the cause and effect of a recession is the banking system has to contract its assets. As business conditions heat up, loans grow too fast, interest rates begin to rise, the banks' cost of funds starts to rise, their capacity to make loans becomes constrained and the growth in the money supply slows to a trickle. **We don't have conditions anywhere near that scenario in the banking system today.** Last week saw news of Bank of New York Mellon charging large customers who choose to store cash at the bank . . . did you get that . . . customers will have negative interest on their deposits! As I have shown before, the growth in deposits has ballooned in recent weeks as investors/consumers have hoarded cash. In the meantime the absolute level of loans has contracted since 2008 and is only now showing modest signs of recovery. These are not the conditions we see at the eve of a recession. While, they do imply a severe level of risk aversion, they are foundational for a potential prolonged recovery in productive growth. *Jeb Terry, Sr. Aug 17, 2011*



Source: Federal Reserve,

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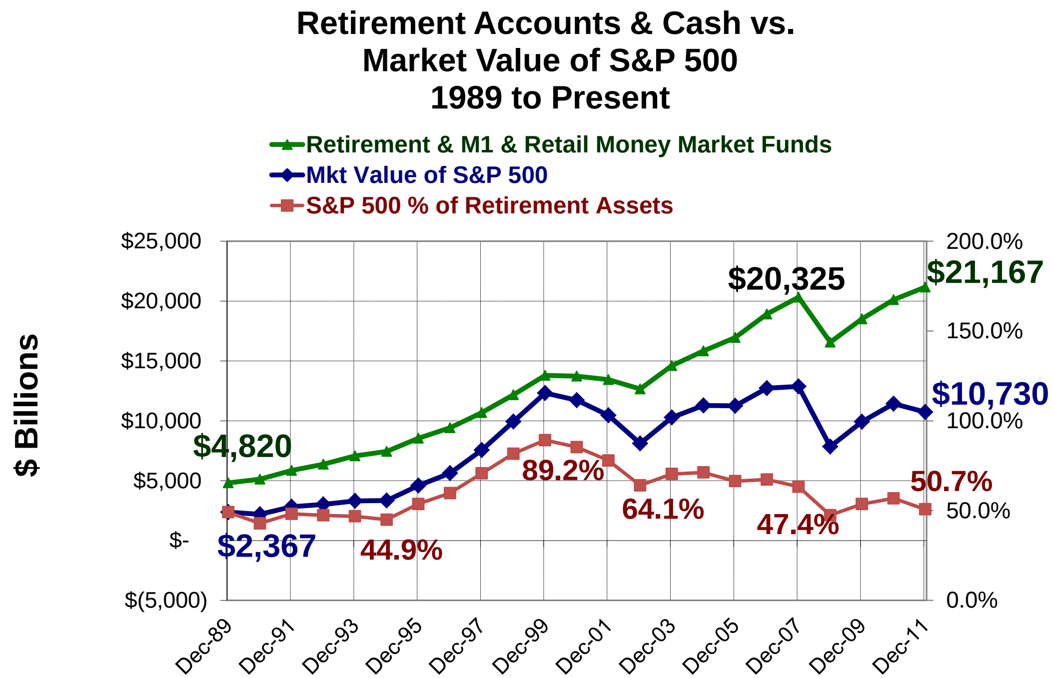
There is a record $21.2 TRILLION in US retirement accounts, cash and bank accounts and retail money market funds.

While there is a record high amount of assets in the retirement complex, there is a low percentage invested in equities. I have used the market value of the S&P 500 as a proxy for the equity portion of the retirement assets. **US investors are underinvested in stocks**. The S&P 500 is equal to only 50% of the value of all retirement assets today compared to 89% in 1999. Not since 1994 (with brief exception on 2008 bear market) have stock values been equal to such a small percentage of retirement and liquid retail assets. A recovery to the average ratio of equities to retirement assets of 66% since 1995 would imply an increase of the S&P 500 market value of over $3.3

trillion or 31% greater than today. **There is not a lack of funds to invest – there is a lack of confidence to invest**. *Jeb Terry, Sr. Aug 17, 2011*



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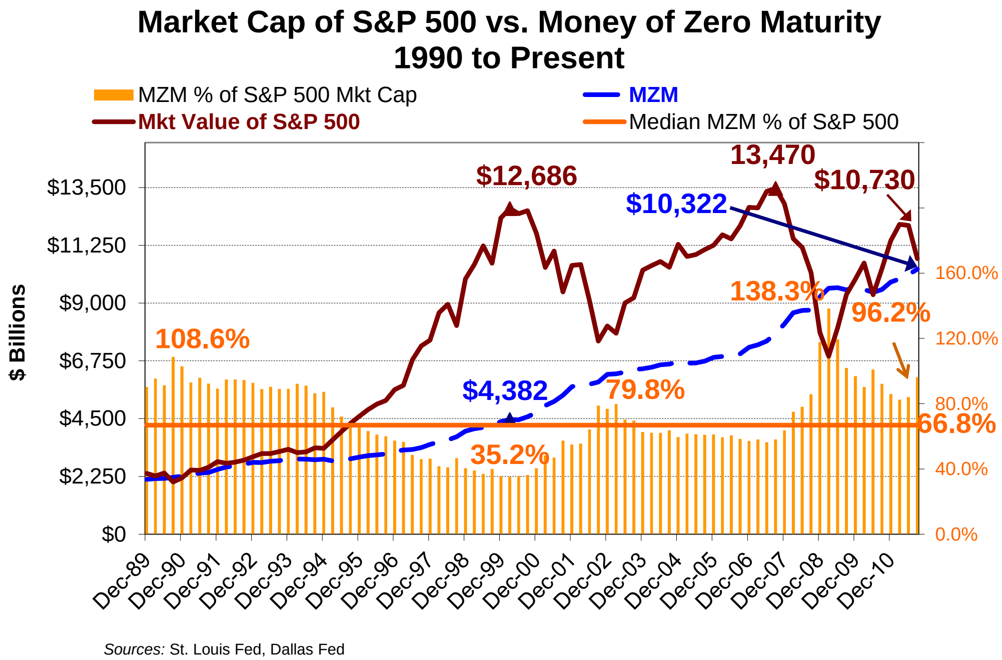
Over $52 billion was stuffed into money market funds last week – the most since the panic of 2008/2009.

Not since the chaotic days of late 2008 and 2009 – when we had much greater uncertainty, illiquidity and systemic crisis than today – have we seen so much money flee risk and go into "money of zero maturity", aka

MZM. MZM is now equal to 96% of the total market value of the S&P 500. This kind of spike in the percentage of near cash relative to equities has only occurred very near market bottoms. *Jeb Terry, Sr. Aug 17, 2011*



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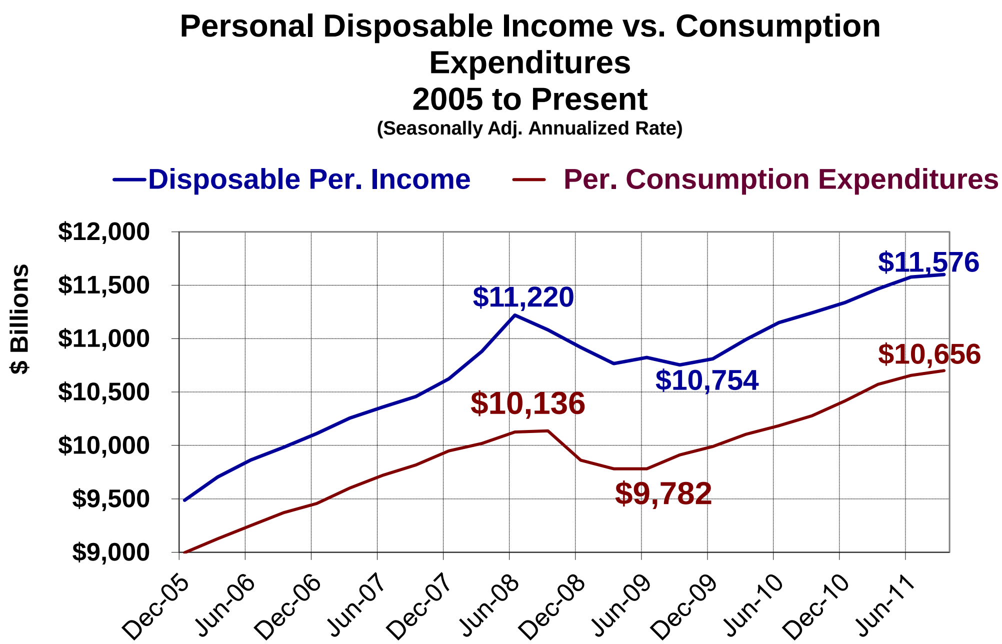
Disposable Personal Income (DPI) and Personal Consumption Expenditures (PCE) are both still on the rise.

Personal income and spending have both recovered fully from the Great Recession. It is unlikely there will be a reversal of the trend albeit some slowing in growth. Since the U.S. economy is centered on the US consumer vs. exports – the odds of a recession in Europe having a pronounced impact on the US economy are lessened. *Jeb Terry, Sr. Aug 17, 2011*



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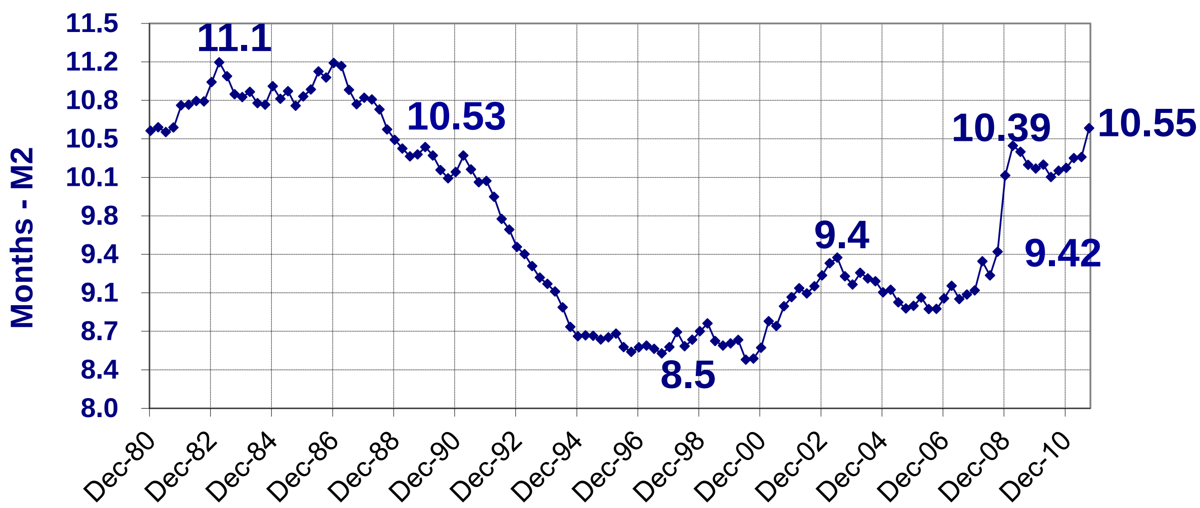
There is over 10 months of personal consumption expenditures (PCE) sitting in cash and money market funds – this is the most in over 20 years.

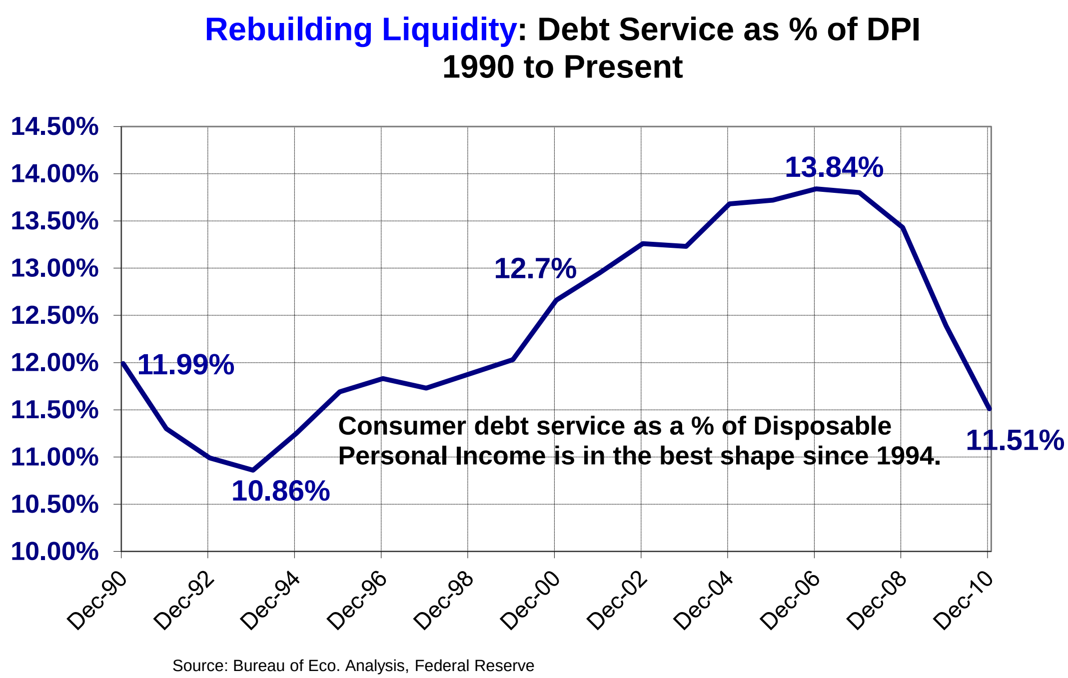
We know that consumers and SMBs have hoarded cash but how does that relate to what is typically spent in a given month? Since the Great Recession, U.S. consumers and businesses have put away more cash faster than any time in recent history. There is now almost 10 ½ months of PCE parked in cash, savings deposits and money market funds earning practically zero percent. The US consumer who has a job is in great financial shape compared to the last 20 years. **This condition is <u>NOT</u> consistent with the onset of a pronounced or prolonged economic slowdown or recession**. *Jeb Terry, Sr. Aug 17, 2011*

Rebuilding Liquidity: Months of PCE Held as Cash, Savings Dep & Retail Money Market Funds 1980 to Aug, 2011



M2 includes a broader set of financial assets held principally by households. M2 consists of M1 plus: (1) savings deposits (which include money market deposit accounts, or MMDAs); (2) small-denomination time deposits (time deposits in amounts of less than $100,000); and (3) balances in retail money market mutual funds (MMMFs).

Consumers are not in a state of financial distress as they were in 2008. In addition to months of spending held in cash reserves, they have more disposable income to cover their reduced debt service. The US consumer has sufficient income to cover their debt service by ~8.7X, a 20% improvement over 2008. This is another indicator that **any sentiment induced economic slowdown can be short lived and not severe**.



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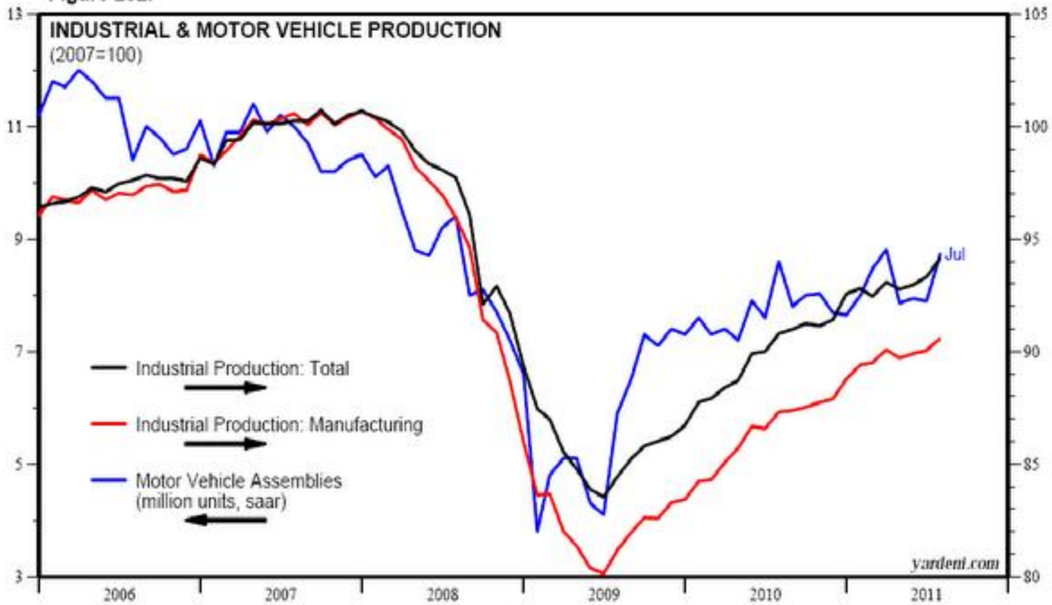
Despite the sentiment and cash hoarding there is still forward momentum in the economy as illustrated in industrial production.

The following chart (courtesy of Yardeni.com) does a good job of showing the state of the recovery in industrial production as of July. Hopefully the slowdown I foresee due to the recent panic attack will only be a short term negative blip in this otherwise encouraging trend. *Jeb Terry, Sr. Aug 17, 2011*

Figure 232.



Source: Federal Reserve Board.

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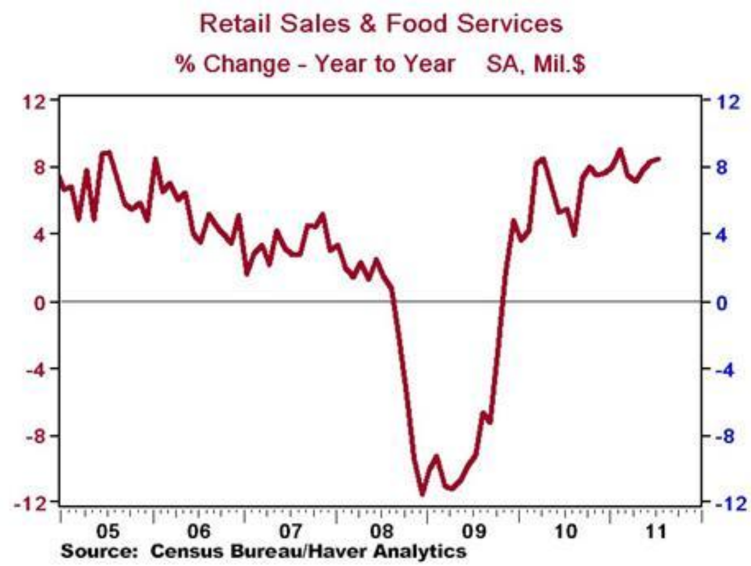
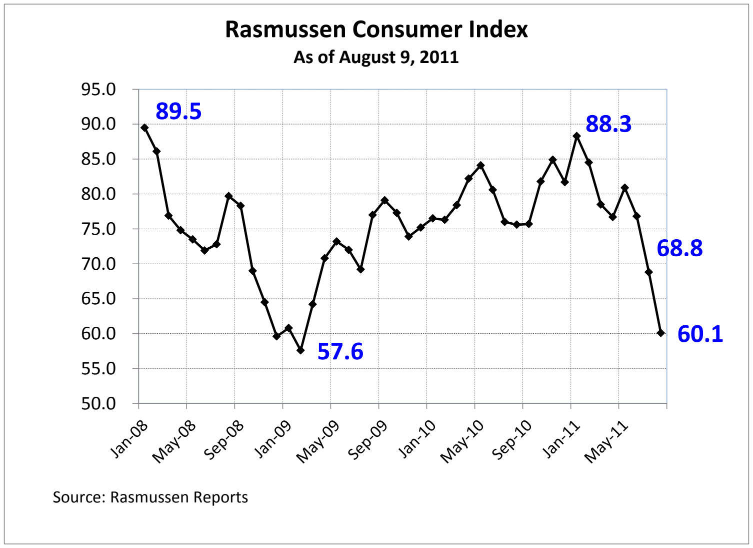
Retail sales show the consumer wasn't panicking in July . . . so says Brian Wesbury at First Trust . . . While I can see the chart is pointing up, we must admit to the absolute collapse in consumer sentiment since the retail sales numbers were compiled.

The US consumer has plenty of funds to fuel retail sales. My concern is the collapse in sentiment in recent weeks due to the fear mongering over the debt ceiling debate and fear of undefined and un-calibrated consequences of a default of Euro sovereign debt. *Jeb Terry, Sr. Aug 17, 2011*



Source: First Trust



Source: RasmussenReports.com

The weak consumer sentiment and panicked hoarding of cash has set the stage for weaker employment in August and September and possibly well into Q4.

The chart from Rasmussen Reports is consistent with other survey information I have recently had an opportunity to read. *Jeb Terry, Sr. Aug 17, 2011*

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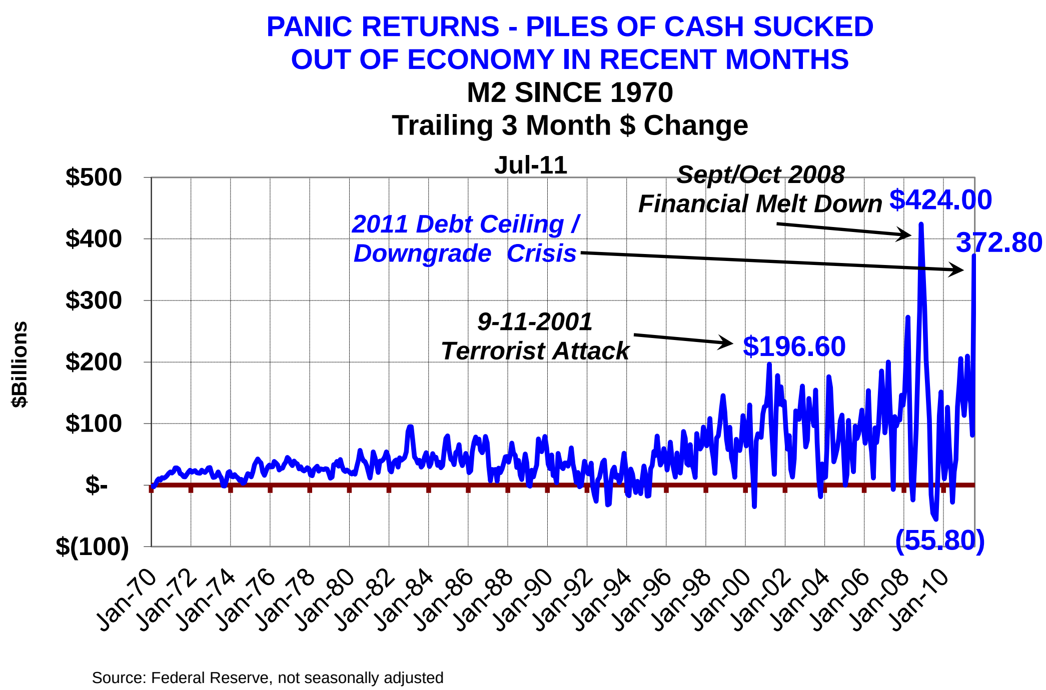
M2 Update – When this much cash gets sucked out of the economy we must expect a slowdown – not necessarily a recession, but certainly a slowdown.

I have updated the data series on money supply to see how severe the panic has been in recent weeks. As expected, the spike in M2 – representing consumer/small business bank accounts and money market funds has exploded upwards. **$272 billion was hoarded just in July alone. July saw the biggest single monthly increase in M2 in both absolute dollar and percentage terms in my data set going back to 1959**. It deprives the real economy of investment. It is logical to expect the upcoming economic reports for August/September to be weak and encouraging to those who are betting on a "double dip" recession. The good news is that the economy isn't anywhere near the shape it was in 2008. This sets up the potential for a quick reversal back into Main Street businesses in Q4. Clearly there are gobs of cash available for the holiday spending season. *Jeb Terry, Sr. Aug 14, 2011*



Source: St. Louis Fed

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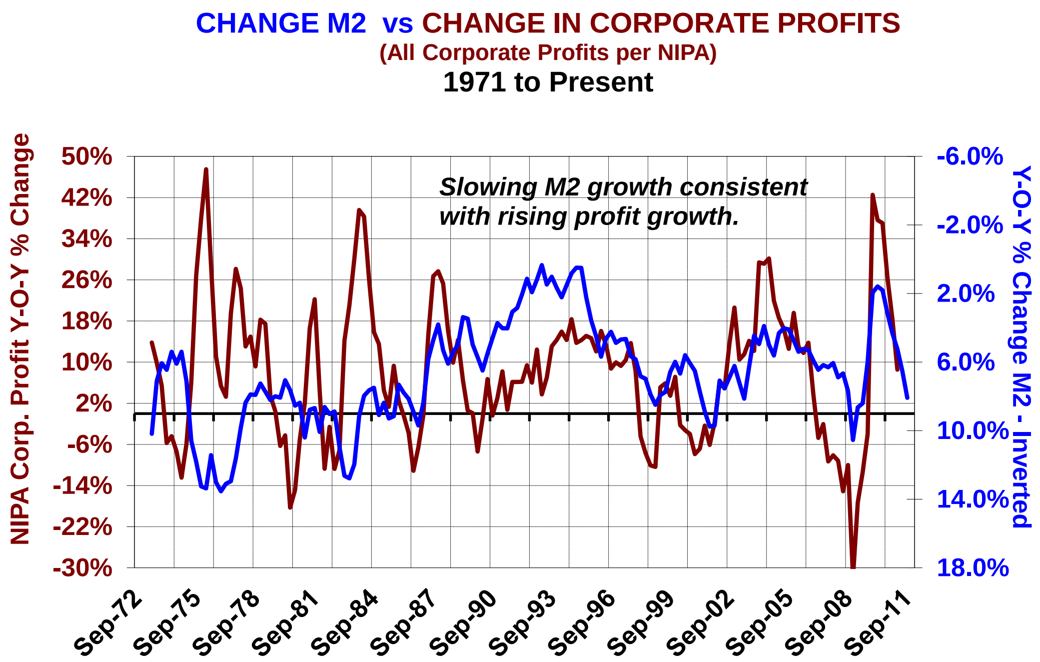
The recent hoarding of cash in M2 portends a slowdown in corporate profit growth.

The panic driven stuffing of cash into banks in recent weeks has set in process an unavoidable slowdown in profit growth. We saw this relationship in 1990, 2001 and 2008. At worst it could cause profits to actually decline although any decline should be modest and short lived. *Jeb Terry, Sr. Aug 17, 2011*



Source: Federal Reserve, BEA - National Income and Products Accounts

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