

Every Pitch Counts Now

Keeping His Eye On The Ball

Joe Terranova, Chief Market Strategist, Virtus Investment Partners, has likened the unpredictable behavior of the capital markets this year to a “baseball season of frustration.” That theme continues in his latest view on the economy in this special mid-quarter commentary.

When entering late innings, successful baseball managers know it's time to focus on pitch counts, defense, and men on base in order to win. In the current economic environment, investors must be ready to do the same.

Here are several key economic indicators – analogous to various pitches – that I'll be watching closely throughout baseball season.

Pitch #1: “The Change-Up”

Key indicator: U.S. Economic Data (Unemployment and Manufacturing)

My view: I'll be watching for further signs of a slowdown in unemployment and manufacturing, just like a slow “change-up” pitch coming over home plate which forces the hitter to slow down the speed of his swing. The economic recovery is entering later stages, which historically means slowing growth. Until data suggests otherwise, this is a slowdown, not a meltdown.

Of less concern to me: U.S. housing and consumer spending data, as the markets have priced-in an extended period of “drag” for these sectors. This is a classic example of “expect the worst and hope for the best.” If there is a surprise in housing and consumer spending, I believe it would be to the upside.

>> **U.S. Private Sector Jobs data**, issued monthly by the U.S. Labor Dept., is a key component of the U.S. employment situation report and the primary monthly indicator of economic activity.

Watch for:

Since hitting bottom in Q1 2009, private sector jobs have been trending higher. Of concern would be a reversal of the uptrend and private sector job losses in concurrent months, reminiscent of the fall of 1982's confirmed “double-dip recession.”

Critical dates:

Releases on
September 3
October 8
November 5
December 3

>> **ISM Manufacturing Index**, issued monthly by the Institute of Supply Management, measures the health of the manufacturing industry, which indicates the prevailing direction of the market. An index value above 50 typically indicates growth and below 50, contraction.

Watch for:

The overall index has been slowing, from 59.7 in May, to 56.2 in June, to 55.5 in July. Of concern would be consecutive monthly readings below the expansion/contraction marker of 50.

Critical dates:

Releases on
September 1
October 1
November 1
December 1

Pitch #2: “Fastball”

Key indicator: U.S. Dollar Trajectory

My view: A rise in the trajectory of the U.S. dollar, just like the pitcher’s fastest ball, would pose a challenge to the economic recovery. The dollar is our most important financial asset in late 2010. Continued weakness is the desired trajectory and necessary to fight deflation.

>> **Trend:** Deflationary pressures continue to persist in the G-3 economies (U.S., Japan, euro zone). The Federal Reserve has aggressively attempted to reflate the economy since early 2009, and the success of these efforts is measured by the performance of the U.S. dollar. Successful reflation lowers the standard of living and monetizes the debt via cheaper currencies – both necessary to fight deflation. Market participants reduced their risk in Q2 2010 as the dollar appreciated in “safe haven” mode in response to the euro currency crisis.

Watch for:

Sustained weakness in the dollar through September and October. Historically, September and October are the two weakest months for the dollar. Since 2001, the dollar’s yearly high has never occurred in either month (though it saw significant appreciation in 2008).

Critical dates:

Throughout
September
and October

Pitch #3: “Curveball”

Key indicator: U.S. Monetary & Fiscal Policy

My view: Will monetary and fiscal policies be introduced that successfully stimulate growth and will any surprise curve balls be thrown? For U.S. monetary policy, quantitative easing may need to be enacted again. Does Fed Chairman Ben Bernanke have the right weaponry in his arsenal? I believe that yes, he has the ability to easily utilize direct asset purchases. As for fiscal policies, with mid-term elections fast approaching, sentiment towards incumbents is clearly negative. Does the Hill have the political will to do what is necessary – i.e., “fiscal policy stimulus” – to help the economic recovery along?

>> **U.S. Monetary Policy:** *the tools used by the Federal Reserve to control interest rates and the money supply.*

Watch for:

Historically, Treasuries are the most desired asset on the Fed’s balance sheet. Although some suggest the FOMC is “out of bullets,” they are not. More unconventional monetary easing can be implemented. Bernanke’s first move will be to directly purchase Treasuries if the recovery continues to falter. A secondary wave lower in housing could be addressed as well that targets a purchase of mortgage-backed securities.

Critical dates:

Scheduled FOMC
meetings on
September 21
November 2-3
December 14

>> **U.S Fiscal Policy:** *stimulus measures by Capitol Hill to control taxes and spending.*

Watch for:

“Doing nothing” has historically been the best approach for incumbents heading into mid-term elections. But this year, Wall Street is clamoring for fiscal policies to restart economic growth. I don’t foresee fiscal stimulus; I expect disappointment. Unemployment benefits were extended to November 30. The critical decision relates to the expiring Bush tax cuts. I expect extended middle income tax cuts and tax increases for higher income brackets, dividends, and capital gains. A curve ball would be if every tax bracket increased – a 10% chance in my opinion – or if the Bush tax cuts are extended 6 to 12 months for everyone. In that unlikely event, it would be to offset a return to the type of plunging markets we saw in the fall of 2008.

Critical dates:

U.S. Congress
reconvenes on
September 13

Pitch #4: “Breaking Ball”

Key indicator: A September Swoon

My view: September is historically one of the worst-performing months for the equity market. Keeping the S&P 500® above this year’s 1010.91 intraday low is what I’ll be watching. If the Index remains above its low on October 1, that will be a positive sign for capital markets for the rest of the year.

Watch for:

I’ll be keeping my eye on three things in September – credit spreads and the prices of oil and copper. The leading indicator for any September swoon is a widening in credit spreads. Also, as we saw in September 2009, a surprisingly strong equity market found support from resilient spot oil and copper prices thanks to emerging market demand. Use of these commodities would indicate that emerging market demand is present again – and a clearly bullish sign for the capital markets the rest of 2010.

Critical dates:

Throughout the month of September

Pitch #5: “Cutter”

Key indicator: Third-Quarter Earnings

My view: As any Yankee fan knows, the first few beats of “Enter Sandman” means the arrival of Mariano Rivera – perfecter of the cut fast ball – to close-out a win. For investors, October earnings season could be the market’s “Sandman.” Continued bottom-line execution, as well as top-line sales growth, will continue to be the catalyst to overcome the global economy’s macro headwinds.

Watch for:

Earnings are what have mattered most during the recovery. I believe the third quarter will show more of the same upside surprise. “Enter Sandman” and the capital markets will like it.

Critical dates:

Third-quarter earnings season kicks off with Alcoa’s release on October 7



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Mr. Terranova is best known for his risk management skills, honed while overseeing the trading operations, particularly oil and natural gas, for MBF Clearing Corp. His leadership of MBF’s trading operations coincided with some of the most calamitous times for the U.S. markets, including the first Gulf War, the 1998 Asian Crisis, 9/11, and the collapse of Amaranth Advisors.

He is a CNBC contributor and frequent panelist for the highly rated CNBC evening program, *Fast Money* and has been a guest on Bloomberg TV and CNN, as well as being quoted in numerous financial media publications. He assisted MBF founder Mark B. Fisher in authoring the book *The Logical Trader*, and wrote a daily energy market commentary for the energy industry and hedge fund community for more than 12 years.

Prior to joining Virtus Investment Partners in 2008, Mr. Terranova, spent 18 years at MBF Clearing Corp., rising to the position of director of trading for the company and all of its subsidiaries. In this capacity, he managed more than 300 traders and support staff for MBF, one of the New York Mercantile Exchange’s largest firms. Before joining MBF, he held positions at both Swiss Banking Corp. and JP Morgan Securities.

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For more information, visit Virtus.com

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