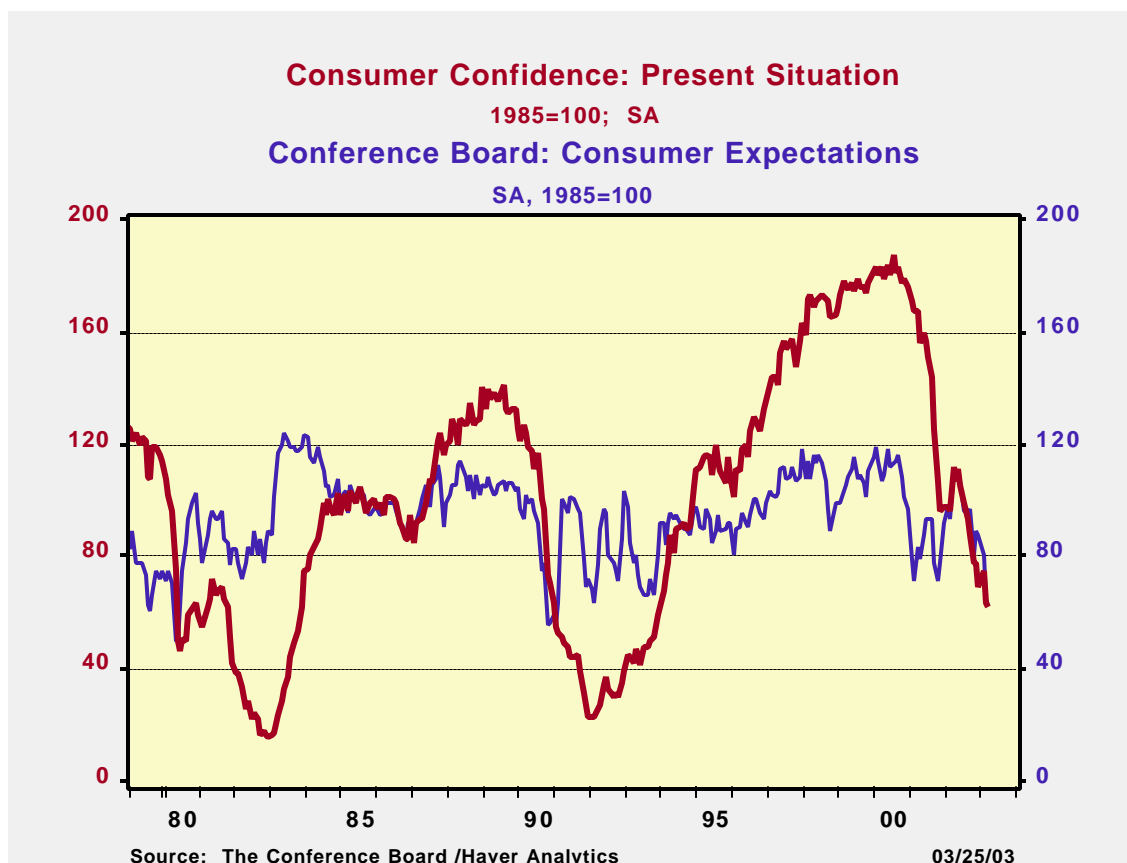




## What Really Matters Regarding Confidence?

The economists at the Bank of America follow various datapoints assiduously and today's Conference Board data for the month of March are not an exception. The real issues for investors are how to read the data (that is what do they really tell us with regard to the confidence of consumers currently), and should we trust the data to forecast what will happen going forward? In the graph below, what strikes me as unusual is the very close parallel between the expectations (forward) measure of confidence and the current measure. That is somewhat uncommon. Only one other time (1983-1985) were the two measures quite so congruent. Note, also that generally the expectations measure leads the current measure. (1980—even with high interest rates;



coincidental up turn in 1987; and the 'wobble of the early 1990's when it was unclear whether the economy was truly turning upward). What also stands out is the effect on expectations of the boom conditions that began in 1995. First current expectations shot up and then they "dragged" the forwards with the interrupt of the Asia Crisis of 1997. Then the true bubble conditions drove up the forwards well past the bursting in mid 2000. Finally, when the economy seemed to bottom out in 2002, forward expectations led and then became virtually coincidental after 9-11. They are falling congruently today.

The forwards tend to act as ballast---when things are bad, consumers see the next period as better than a



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mere extrapolation of the immediate past. And when things are boomy, they show some proper amount of skepticism going forward. This suggests that “congruency” is a measure of how uncertain consumers are in projecting their current feelings going forward.

When the policy formulators talk about uncertainty, what they have in mind is the inability of economic agents to look ahead and “price” the future. Risk is all about pricing outcomes going forward. Uncertainty is about the inability to put a price on very diverse outcomes. This is the binary world in which we now live. The Iraq war is a perfect example, but it is only one of the factors bearing on the spending decisions of economic agents. Economic agents cannot put a price on a favorable outcome---it could go either way. Were it “clear,” we would get sharp divergence between the current and the forward situation. It is not simply a situation of whether Saddam Hussein is evicted from Baghdad. It is a question of how the eviction takes place; what the costs will be, and, finally, what the situation in the Middle East and the rest of the troubled areas of the world will be when the formal shooting stops.

Remarkably, the forward measure has not fallen more drastically. Perhaps it should have fallen more but when the survey data were taken, it is doubtful that the most recent ‘setbacks’ were in the minds of consumers. If the survey were taken today, the forwards might have fallen far more. The lesson for investors is that a “bet” today is a bi-modal outcome circumstance and the effects on the price of the asset will be discontinuous. The choice is ‘buying’ volatile outcomes that can be very ‘good,’ or very ‘bad.’ The other choice is to take advantage of the spring and sharpen your golf game.



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