

Weekly Economic Commentary



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Highlights

- A quiet week for data, but policy (both fiscal and monetary), along with a batch of European economic data, will greet market participants as they return from vacation mode.
- After the best week for economic data in the United States since spring 2010, should markets rethink the double-dip scenario?

Is The Tide Turning?

While last week (August 30 – September 3) was an eventful week for the economy and financial markets, this week's economic and policy calendar is relatively light. Aside from the regular weekly reports on retail sales, mortgage applications, and initial claims for unemployment insurance, the Federal Reserve's (Fed) Beige Book (a qualitative assessment of the economy from business contacts in each of the 12 Federal Reserve bank districts across the country), and the July merchandise trade report are the two key economic reports of the week.

Although there is little in the way of U.S. economic data this week, market participants will still have plenty of information to absorb. Fiscal policy—in the form of more infrastructure spending and several business oriented tax credits—may take center stage despite Congress having less than 20 working days between when it returns from summer break on September 13, and when it adjourns for the final push of the midterm election campaign on October 8.

The table demonstrates that about \$275 billion of 2009's \$787 billion stimulus package is yet to be spent, and roughly, half of the amount to be spent is in the form of contracts, grants, and loans, which has the best chance to save or create jobs.

Still More Stimulus in the Pipeline: Distribution of the \$787 Billion in the American Recovery and Reinvestment Act of 2009

Category	Total Recovery Act Funds	Funds Paid Out	Percent Paid Out
Tax Benefits	\$288B	\$223B	77%
Contracts, Grants, Loans	\$275B	\$145B	53%
Entitlements	\$244B	\$144B	64%
Total	\$787B	\$512B	65

In addition, no fewer than seven major central banks meet to set policy this week, including:

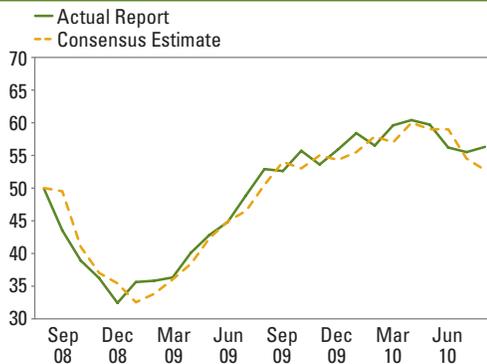
- The Bank of Japan (BOJ)
- India
- Bank of Canada (BOC)
- The Reserve Bank of Australia (RBA)
- South Korea
- Bank of England (BOE)
- South Africa

Economic Calendar

Monday, September 6 Holiday	Thursday, September 9 Initial Claims <i>wk 09/04</i>
Wednesday, September 8 Consumer Credit <i>July</i>	Trade Balance <i>July</i>
Fed's Beige Book	Friday, September 10 Wholesale Inventories <i>July</i>



1 The August ISM Came in Better Than Expected, And Better Than the Prior Month



Source: Bloomberg 9/7/10

The central banks in Canada, India, and South Korea are likely to raise rates further this week. Canada began tightening in June 2010, India began tightening in late 2009, while South Korea began in July 2010. The RBA, the BOJ, and the BOE are unlikely to change rates. The BOE and the BOJ are likely to keep the door open for more easing. Meanwhile, the South African central bank is widely expected to cut rates again. Central bank tightening was one of the headwinds we expected to arise in the second half of 2010.

There is no economic data due in China this week. However, next week (September 13–17) is when the majority of the Chinese economic data for August is due out. There is a ton of economic data due in Europe this week, although none is particularly crucial to the market's assessment of the European economy's health as the tax hikes and government spending cuts implemented earlier this summer begin to take hold.

Should the Market Rethink the Double-Dip?

Throughout late spring through mid-August, most of the economic data released in the United States came in below expectations and represented a deceleration from the prior period. In contrast, the vast majority of the economic data in the United States released between June 2009 and early spring of 2010 was both better-than-expected and an improvement over the prior month. While this pattern of data (namely a peaking in leading indicators) is typical as an economy transitions from recovery to sustainable growth, financial markets began to worry that this typical slowdown might be signaling that the U.S. economy was headed for a return to recession, referred to by some as a double-dip.

In mid-August 2010, after several months of leading indicators' upward momentum is beginning to slow, the market's expectations for the economic data were lowered, and the data began to beat these lowered expectations more often than not. In some cases, the data was even an improvement from the prior period's reading. During this past week (August 30–September 3) roughly two-thirds of the U.S. economic data was better than expected, and many of the key reports showed an improvement over the prior period. While we do not think the tone of last week's data represented a "regime change," it strongly suggests that financial markets have been overly concerned with a double-dip scenario. Last week's data may cause some to rethink or refine their outlooks for a double-dip recession.

While the better-than-expected and better-than-prior-month August jobs report was the headliner last week, many other reports contributed to one of the best weeks for United States economic data in several months. Those reports included:

- The August reading of the Institute of Supply Management's (ISM) Index of manufacturing, one of our favorite leading indicators of the economy and corporate earnings. The August ISM was better than expected and increased between July and August. The report also came in above the higher end of estimates. That is two months in a row where ISM came in better than expected, and five of the past six months.
- August chain store sales came in better than expected (+3.5% year-over-year gain in sales). Many retailers noted that sales improved over the



On balance, the private sector has created 755,000 jobs since last fall, or about 75,000 per month. This pace of job growth is probably not enough to push the unemployment rate (at 9.6% in August, up from 9.5% in July) significantly lower, but it does not suggest that the economy is in danger of a double-dip recession either.

course of the month as Labor Day approached. At a year-over-year pace of 3.5%, same store sales suggest that the consumer is still "muddling along", but that neither a collapse nor a boom in consumer spending is likely in the coming months.

- Mortgage applications rose 2.7% in the week ending August 27 (versus the prior week). Both purchase (+1.8% week-over-week) and refinance (+2.8% week-over-week) applications posted gains. Purchase applications are now up in six of the past seven weeks, after crashing in May and June following the end of first-time homebuyer tax credit. Purchase activity has not been this consistently active since the final month of the first-time homebuyer tax credit in April 2010. Not surprisingly, refinance applications have posted week-over-week gains in each of the last five weeks, and have risen in 13 of the 17 weeks since the end of April. Refinance applications are up 150% from their April lows. The wave of refinancing is putting extra cash in consumers' pockets, which they may use to spend, save or pay down debt.
- Layoff announcements eased again in August. Challenger, Gray and Christmas is an outplacement firm that tallies job cut announcements each month. These are announced layoffs (not actual separations), and while the firm surveys only U.S.- based firms, the data includes global jobs, not just U.S. based ones. Layoff announcements, which tend to lead initial claims for unemployment insurance by a few months at turning points, fell by around 7,000 between July and August, and are down 55% from a year ago. At just over 34,000, layoff announcements in August 2010 were the lowest since 2000, when the unemployment rate was around 4.0%. The unemployment rate is now 9.5%. Year-to-date in 2010, monthly layoff announcements have averaged around 47,000 per month, a reading not matched since the final eight months of 2000. This data suggests that corporations have cut to the bone and then some, and are reluctant to cut more, but as the August employment report showed, they have also been reluctant to hire.

As noted, the key report of last week was the much anticipated August jobs report. In keeping with the theme of most of the other reports released last week, the August jobs report was better than expected, and marked an improvement in the private sector labor market relative to July. The private sector created 67,000 jobs in August versus expectations of a 40,000 gain. In addition, there were significant upward revisions to private sector job growth in both June and July. On balance, the private sector has created 755,000 jobs since last fall, or about 75,000 per month. This pace of job growth is probably not enough to push the unemployment rate (at 9.6% in August, up from 9.5% in July) significantly lower, but it does not suggest that the economy is in danger of a double-dip recession either.

So, the economy and the labor market continue to muddle along here, and both are probably still weak enough to elicit more support from the Federal Reserve in the form of another round of quantitative easing.

The components of the August jobs report, while not spectacular, were mostly encouraging. While some of the "leading indicators" of the labor market (overtime hours, hours worked, household employment) improved between July and August, some others, including manufacturing



employment, retail trade employment, and the diffusion indices (number of industries adding workers less the number of industries shedding workers), deteriorated between July and August. The increase in hours worked and overtime hours in manufacturing suggest that while businesses still have not fully committed to the recovery, they are now probably stretching the productive capacity of their current workers, and that more hiring is likely in the months ahead.

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Investing in international and emerging markets may entail additional risks such as currency fluctuation and political instability. Investing in small-cap stocks includes specific risks such as greater volatility and potentially less liquidity.

Stock investing involves risk including loss of principal. Past performance is not a guarantee of future results.

The ISM index is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders, and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

Challenger, Gray & Christmas is the oldest executive outplacement firm in the United States. The firm conducts regular surveys and issues reports on the state of the economy, employment, job-seeking, layoffs, and executive compensation.

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