Weekly Economic Commentary

December 7, 2009

Data Suggest at Solid Finish for U.S. GDP Growth in 2009

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ECONOMIC CALENDAR

Monday, Dec 7
Consumer Credit
Oct

Wednesday, Dec 9
Wholesale Inventories
Oct

Thursday, Dec 10
Initial Claims
wk 12/05

Trade Balance
Oct

Treasury Statement
Nov

Friday, Dec 11
Import Price Index
Nov

Retail Sales X-Autos
Nov

Retail Sales
Nov

Business Inventories
Oct

U of Mich Consumer Sentiment
Dec

Last week's busy slate of economic data and events supported our view that the U.S. economy will post a 3.0 to 3.5% growth rate (as measured by real Gross Domestic Product) in Q4 2009, and that growth will continue at or above that pace over the first part of 2010. There were certainly some disappointing data points last week, among them:

- The below 50 reading on the Institute of Supply Management's service sector index for November.
- The weaker than expected chain store sales data for November.
- A further drop in consumer confidence in early December.
- The sharp downward revisions to construction activity in August and September suggest that Q3 GDP will be revised down further.

However, there was better than expected news last week on:

- Jobless claims in early December, which fell to a 15-month low.
- Vehicle sales in November, which surprised to the high side without any impetus from "cash for clunkers".
- Pending home sales in October, which posted a robust 3.7% month over month gain, suggesting that the recovery in the housing market than began in early 2009 will persist well into 2010.

This week, markets will digest a smattering of U.S. economic data for October:

- Wholesale inventories
- Business inventories
- Consumer credit and
- Merchandise trade

November (import prices), early December (weekly retail sales and jobless claims), along with a key batch of data on China's economy in November, will be digested by the markets as well. In addition, several key Federal Reserve officials are scheduled to give major speeches this week, while the market continues to try to discern the timing and severity of the Fed's first steps toward tightening policy. On the fiscal policy front this week, there is likely to be increased talk of using the monies repaid into the Troubled Asset Relief Program (TARP) to fund a "jobs program" with the unemployment rate still politically uncomfortably high at 10.0% heading into a midterm election year in 2010.

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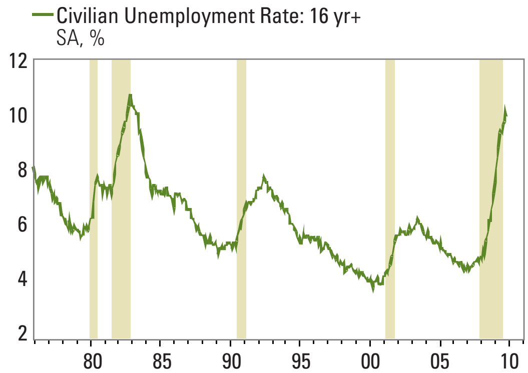
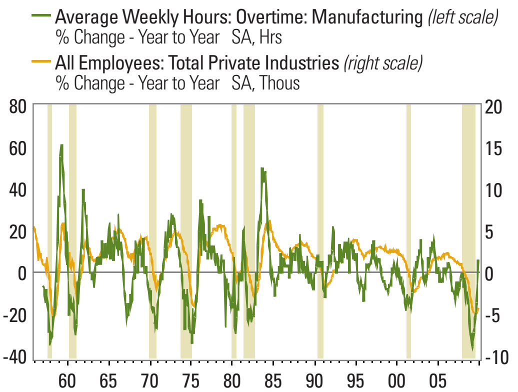
1 The Unemployment Rate Ticked Down to 10.0% in November, But Remains Unacceptably High.



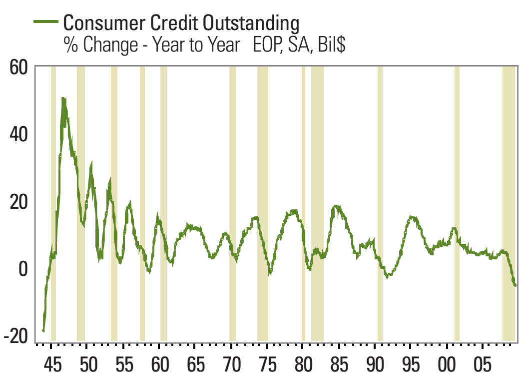
Source: Bureau of Labor Statistics/Haver Analytics 12/07/09

2 The Leading Components of the Jobs Report, Including the Rise in Overtime Hours, Suggests That Job Growth is Right Around the Corner.



Source: Bureau of Labor Statistics/Haver Analytics 12/07/09

3 It is common to see consumer credit growth slow (decelerate) or decline outright as the economy moves through and out of a recession.



Source: Federal Reserve Board/Haver Analytics 12/04/09

The key economic report last week was the November employment report, which is actually two reports: one that surveys households and generates the unemployment rate data, and the other that surveys business establishments and generates the nonfarm payroll job count.

The November jobs report was much better than expected, and supports our long-held view that the economy remains on track to create jobs by early 2010. The payroll job count fell by only 11,000 in November, versus expectations of a 125,000 decline. The 11,000 drop in November was better than even the most optimistic forecast, which called for a 30,000 drop. The job counts in September and October were revised sharply higher, making the 11,000 drop in November look even more impressive. The unemployment rate ticked down to a still high 10.0% in November, from 10.2% in October. The better-than-expected jobs report was not a fluke, as the internals of the report (such as hours worked, overtime hours, private sector employment, and temporary help employment) were all positive, and have been signaling a large improvement in the labor market for months.

The Week Ahead

The section below provides some observations on this week's key economic releases. Alongside the preview are questions that markets, the media and, yes, economists are likely to be asking as the data is released.

October Consumer Credit (Monday, December 7)

- The October consumer credit report was released as the Weekly Economic Commentary was being published.
- Consumer credit outstanding has plunged this year as consumers continue to repair their balance sheets. Consumer credit fell by $15 billion between August and September and is down an astonishing $122.5 billion (4.8%) from a year ago, the largest drop on record (post WWII) for this series.
- The good news is that it is common to see consumer credit growth slow (decelerate), or decline outright, as the economy moves through and out of a recession [Chart 3].
- Another silver lining in the dramatic drop in consumer credit ($126 billion since the peak in mid 2008) is that consumers have already begun to repair their balance sheets, although we should note that a portion of the drop herein was involuntary (credit lines pulled, bankruptcies, etc.).
- The bad news is that the ratio of disposable consumer credit outstanding to disposable income remains elevated by historical standards, and may have to come down further, which will dampen consumer spending in the coming quarters.

- Real disposable income and consumer net worth (value of stocks, bonds, housing, consumer durables), both of which are up sharply over the past nine months, are better predictors of future consumer spending than consumer credit.

4 Judging by the new export orders data embedded within the various national and regional ISM and Federal Reserve manufacturing surveys for October and November, there is solid evidence that exports have begun to turn up sharply.

Source: Institute for Supply Management/Haver Analytics 12/04/09

October Trade Balance (Thursday, December 10)

- In Q3 2009, U.S. exports surged as the global economy recovered, but U.S. imports surged by even more, reflecting a rebound in business and consumer spending. As a result, net exports were a drag on real Gross Domestic Product (GDP) growth in Q3 2009, shaving about 0.8% off growth. It was the first time since 2005 that trade was a drag on GDP growth.
- With global economies recovering quickly, we expect the trade sector to once again positively contribute to GDP growth in Q4 2009 and in 2010.
- The October trade data will provide the first hard look at the performance of the trade sector in Q4 2009.
- Judging by the new export orders data, embedded within the various national and regional ISM and Federal Reserve manufacturing surveys for October and November, there is solid evidence that exports have begun to turn up sharply.
- With the economy improving, import growth is likely to rebound, especially given the recent uptick in oil prices.
- Exports have helped to lead the U.S. economy out of recession during the last two recoveries, in 1991 and in 2001.

Company guidance from retailers, along with the weekly readings on retail sales from the International Council of Shopping Centers (ICSC) and the various consolidators of online and holiday shopping trends, suggest that while the Thanksgiving weekend was strong for shopping, it was not enough to offset a very weak start to the month of November.

November Retail Sales (Friday, December 11)

- Company guidance from retailers, along with the weekly readings on retail sales from the International Council of Shopping Centers (ICSC) and the various consolidators of online and holiday shopping trends, suggest that while the Thanksgiving weekend was strong for shopping, it was not enough to offset a very weak start to the month of November.
- Overall, retail sales in November are likely to be strong, due to auto sales, which surprised to the upside again in November. Consensus calls for a 0.7% month over month gain in retail sales in November.
- Although the gain in auto sales between October and November was "clean" (i.e. no impact from cash for clunkers"), the market will still want to see strength outside of autos (and gasoline). The consensus expects retail sales, excluding autos, to rise by 0.4% in November versus October, which if realized, would be the fourth consecutive month-over-month gain in this metric.
- Chain store sales posted week-over-week declines in three of the four weeks of November.
- Most measures of consumer sentiment rose between October and November, while gasoline prices rose about 10 cents per gallon.

- After the third coolest October on record (dating back to 1895), the temperatures in November were warmer than usual for most of the month, and likely held down sales of seasonal clothing.
- Drier weather in November versus October should allow sales of building materials to rebound in November after a weak October.

Weekly Market Commentary

December 7, 2009

Be Careful What You Wish For

Jeffrey Kleintop, CFA
Chief Market Strategist
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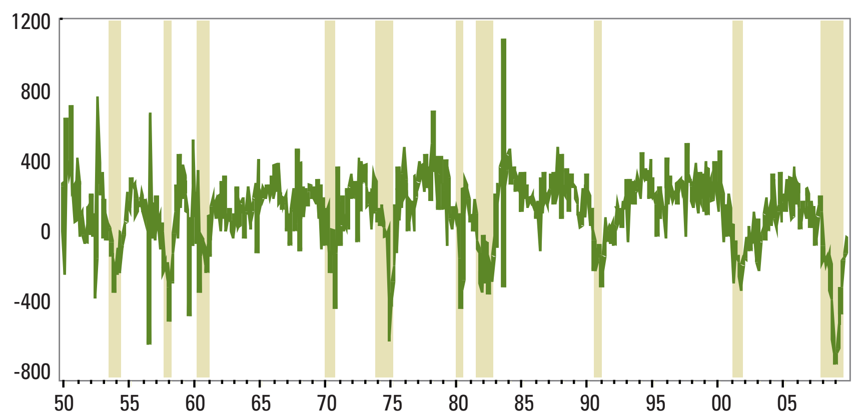
Highlights

- The signs of a turnaround in the labor market are important to the sustainability of the recovery; however, we have to be careful what we wish for since it may also bring less positive news for investors.
- Historically, stocks and bonds perform better leading up to the point when job growth turns positive than they do after.
- Performance was still positive for both stocks and bonds following the return of job growth—just the magnitude of the gain that was smaller.
- We expect further gains in the coming months in both the stock and bond market as job growth returns and the economy continues to heal from the Great Recession.

The November employment report from the Bureau of Labor Statistics released on Friday, reflected only 11,000 jobs lost last month. Of course, this is still 11,000 too many, but far fewer than expected and reflects the ongoing trend in the improvement in the job market. At the peak of the job losses in January of 2009, the U.S. lost over 700,000 jobs. Since then, the improvement averaged about 75,000 jobs per month. If this pace continues, the December report will show a net gain in jobs. The November employment report included revisions to the prior two months to show a net improvement of 159,000 jobs. In fact, if this trend in positive revisions continues next month the November job net change may need a revision to an overall gain. In either case, as we have been predicting for some time, the U.S. economy is on the cusp of job growth as we end 2009.

Monthly Change in U.S. Jobs Turns Positive After Recession Ends
Month Change in Total Non-Farm Payrolls Seasonally Adjusted 3 Month Moving Average



Source: Bureau of Labor Statistics, Haver

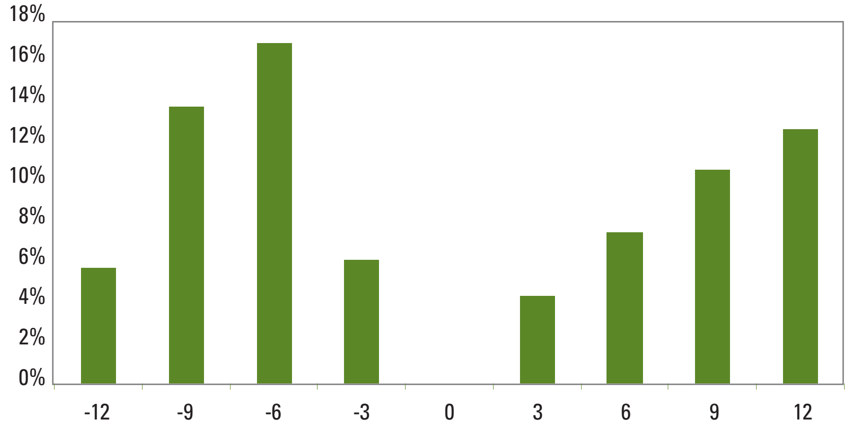
Historically, stocks and bonds perform better leading up to the point when job growth turns positive than they do after.

While the sign of a turnaround in the labor market is important to the sustainability of the recovery, we have to be careful what we wish for since job gains may also bring less positive news for investors. Historically, stocks and bonds perform better leading up to the point when job growth turns positive than they do after. Furthermore, history has shown that the most powerful rebounds in the markets take place as investors' price in expectations for economic recovery, leading profits, as early signs of growth, to emerge well ahead of actual job growth, which is more of a lagging indicator of recovery.

Since 1950, the performance of the S&P 500 in the three-, six-, nine-, and twelve-month periods leading up to when jobs began to grow again were all stronger than during the three, six, nine, and twelve months following the return of job growth.

Stocks Perform Better Before Jobs Growth Turns Positive

S&P 500 Performance over Months Leading Up to and Following First Month of Job Growth after Recession



	12 Months Before	9 Months Before	6 Months Before	3 Months Before	3 Months After	6 Months After	9 Months After	12 Months After
4/30/1954	15%	14%	15%	8%	9%	12%	30%	34%
6/30/1958	-4%	7%	13%	7%	11%	22%	23%	29%
3/31/1961	18%	15%	22%	12%	-1%	2%	10%	6%
12/31/1970	0%	3%	27%	9%	9%	8%	7%	11%
5/31/1975	4%	26%	30%	12%	-5%	0%	9%	10%
8/31/1980	12%	15%	8%	10%	15%	7%	8%	0%
1/31/1983	21%	25%	36%	9%	13%	12%	13%	12%
6/30/1991	4%	21%	12%	-1%	4%	12%	9%	10%
6/30/2002	-19%	-5%	-14%	-14%	-18%	-11%	-14%	-2%
Average	**6%**	**13%**	**17%**	**6%**	**4%**	**7%**	**10%**	**12%**
Current	22%	49%	19%	7%				

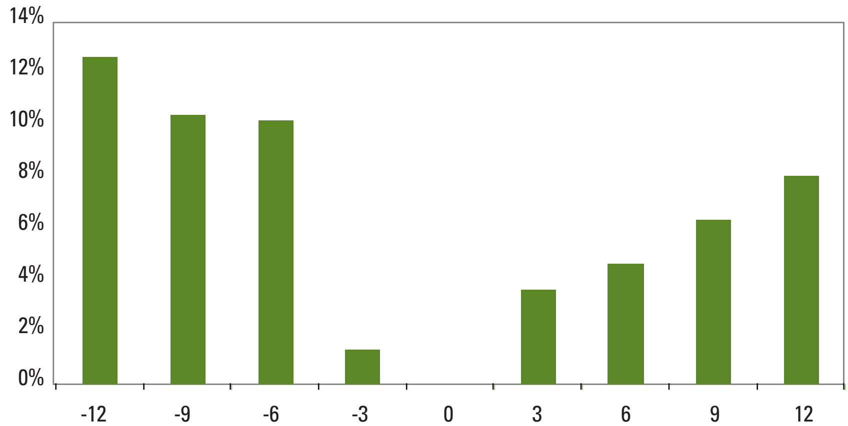
Source: LPL Financial, Bloomberg

The S&P 500 is an unmanaged index, which cannot be invested into directly. Past performance is no guarantee of future results.

In the bond market, we can use the Barclays Aggregate bond index to go as far back as the early 1980s recession to measure the performance around recoveries in the labor market. In the six-, nine-, and twelve-month periods leading up to the point when jobs began to grow again, returns were higher than those in the six, nine, and twelve months following the return of job growth. The only year where gains three months before the return of job growth was better than the returns three months after, was 1980. This resulted in the weak comparison of the three-month averages of before and after the return of job growth.

Bonds Perform Better Before Jobs Growth Turns Positive

Barclays Aggregate Bond Index Performance over Months Leading Up to and Following First Month of Job Growth After Recession



	12 Months Before	9 Months Before	6 Months Before	3 Months Before	3 Months After	6 Months After	9 Months After	12 Months After
9/30/1980	-2%	1%	11%	-7%	1%	2%	2%	-3%
5/31/1983	28%	18%	7%	2%	-2%	3%	5%	0%
8/31/1991	15%	10%	6%	4%	4%	6%	9%	13%
10/31/2002	6%	7%	6%	3%	2%	4%	2%	5%
Average	**12%**	**9%**	**7%**	**0%**	**2%**	**4%**	**4%**	**4%**
Current	12%	9%	6%	3%				

Source: LPL Financial, Bloomberg

The S&P 500 is an unmanaged index, which cannot be invested into directly. Past performance is no guarantee of future results.

The historical record suggests that market performance in the coming months may be less positive than the recent pace of gains, as job growth returns. Nevertheless, and most importantly, performance was still positive for both stocks and bonds following the return of job growth—it was just the magnitude of the gain that was smaller. Only in 2002-03 was stock market performance negative 6-12 months after job growth returned, as the second Gulf War weighed on the markets until March of 2003. We expect further gains in the coming months in both the stock and bond markets as job growth returns and the economy continues to heal from the Great Recession.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

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.

Small-cap stocks may be subject to higher degree of risk than more established companies' securities. The illiquidity of the small-cap market may adversely affect the value of these investments.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rate rise and are subject to availability and change in price.

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