

Weekly Economic Commentary

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Highlights

- Policy matters continue to trump actual data.
- Might this week's batch of economic data actually matter?

Economic Calendar

Monday, October 3 Construction Spending <i>Aug</i>	Challenger Layoff Announcements <i>Sep</i>
ISM Manufacturing <i>Sep</i>	Thursday, October 6 Initial Claims <i>wk 09/30</i>
Domestic Light Vehicle Sales <i>Sep</i>	Chain Store Sales <i>Sep</i>
Tuesday, October 4 Factory Orders <i>Aug</i>	Friday, October 7 Private Sector Payrolls <i>Sep</i>
Bernanke Testimony	Unemployment Rate <i>Sep</i>
Wednesday, October 5 MBA Mortgage Applications Index <i>wk 09/30</i>	Nonfarm Payrolls <i>Sep</i>
ADP Employment Change <i>Sep</i>	Wholesale Inventories <i>Aug</i>
ISM Nonmanufacturing <i>Sep</i>	Consumer Credit <i>Aug</i>

Does Data Matter?

Since the mid-summer 2011 debate over the debt ceiling in the United States, policy at home and abroad (both fiscal and monetary) has dominated the investment landscape. During that time, financial markets here in the United States and across the globe have largely priced in a recession, with equity prices (as measured by the S&P 500 Index) down 15% since mid-July. While policy remains key (markets are still calling out for bold, coordinated policy actions here and abroad), economic and corporate data are likely to dominate the headlines this week, although there are plenty of policy events on tap as well.

As we have noted in our recent commentaries, the U.S. economy remains fragile and vulnerable to an exogenous shock (i.e. an oil price spike, a massive natural disaster, large-scale terror attack, 2008-style credit crunch, a trade war, etc.) and to policy mistakes, both at home and abroad. However, our forecast remains that the economy will continue to sputter along, with growth in the third quarter better than the second quarter, in part, due to a rebound in auto production and auto sales. Our view remains that real gross domestic product (GDP) growth in the recently completed third quarter of 2011 will be between 2.0 and 2.5%, more than double the meager 0.8% annualized growth rate seen in the first half of 2011. Consumer spending, business capital spending, construction of nonresidential buildings and exports should help to boost GDP in the third quarter. Construction of housing and state and local government spending will continue to be drags on growth in the third quarter.

Last week's (September 26–30) relatively favorable economic and corporate data in the United States supported our view of slow growth but no recession and 14% year-over-year gains in profits in the third quarter. The S&P 500 Index was unchanged on the week, and was on course for a decent weekly gain until the last few hours of trading on Friday, September 30, the last trading day of the tumultuous third quarter of 2011.

Over the next week, financial markets will digest key reports for September on consumer spending (vehicles sales, chain store sales), manufacturing (ISM), the service sector (non-manufacturing ISM), housing and construction, and the labor market (ADP, Challenger and the government's job report). With the market having already priced in a recession, the bar is relatively low for this set of data.

Although data is likely to dominate this week, policy is not going away as a potentially market moving force. On the monetary policy front, Fed



Chairman Bernanke is set to deliver testimony before the Joint Economic Committee of Congress on Tuesday, October 4, the very same day that Congressman Ron Paul of Texas, who chairs the committee in the House of Representatives that oversees the Fed, will hold a hearing entitled “Auditing the Fed.” In addition, there are six other public appearances by Fed officials on the docket this week. The Fed will release the minutes of its September 20–21 Federal Open Market Committee (FOMC) meeting next Tuesday, October 11. The next Beige Book, a qualitative assessment of business and banking conditions conducted in each of the 12 regional Federal Reserve districts prior to every FOMC meeting, is due out on October 19. The next FOMC meeting is on November 2.

It is also a busy week for monetary policy outside the United States. The Reserve Bank of Australia (RBA), the Bank of England (BOE), the European Central Bank (ECB), the Bank of Japan (BOJ) and the central banks of Peru, Poland, Serbia, Kenya and Ghana all meet this week to set policy. Of these, only Serbia is expected by market participants to cut rates, but bold coordinated policy action (unexpected rate cuts, more quantitative easing, etc.) from the BOE, BOJ and ECB would be embraced by market participants.

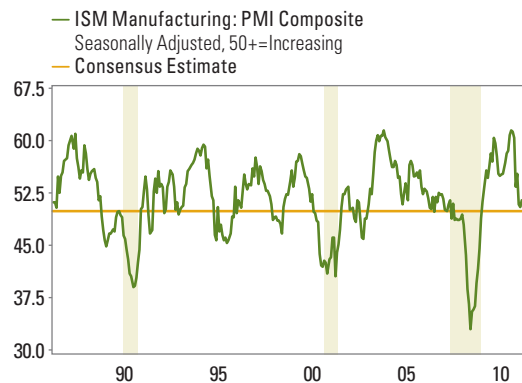
As we have noted for several weeks in the *Weekly Economic Commentary*, central banks that have been tightening policy over the past two years have either stopped raising rates, or begun to cut rates, as inflation risks fade amid a sharp slowdown in economic activity and prospects for future growth wane. Examples in this group include the central banks in Brazil, Russia, New Zealand, Israel and Australia, as well as the ECB. Most notably, China’s central bank has hinted in recent weeks that it is close to the end of its rate hike regime. China’s central bank does not meet on a set schedule, and a change in policy direction by the Peoples Bank of China (PBOC), China’s central bank, could come at any time. Meanwhile, central banks that have been cutting rates are looking to do more. Examples here include the Fed, the BOE and the BOJ. Two of these three central banks meet this week.

Fiscal policy remains at the heart of the ongoing market turmoil. Despite a vote in the German legislature last week to approve the European Financial Stability Fund—essentially a European version of the Troubled Asset Relief Program (TARP)—that will be used to recapitalize banks in Europe and help to forestall a default in Greece, financial markets remained worried. News over the weekend that rating agency Standard and Poor’s has reaffirmed the United Kingdom’s AAA rating will likely increase calls here in the United States for more budget cuts. Although the Greek government passed another round of budget cuts over the weekend of October 1–2, it also said that the cuts were not enough to effectively reduce the deficit to the level required by the European Central Bank, the European Union and the International Monetary Authority, known as “the troika”, so that Greece could secure its troika-led aid payout and avoid default. We expect that worries surrounding European debt will continue to weigh on market and economic sentiment for many months.

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1 The ISM Report Continues to Point to Economic Growth, Not Recession



Source: Institute for Supply Management, Haver Analytics 10/03/11

(Shaded areas indicate recession)

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.

Purchasing Managers Index (PMI) is an indicator of the economic health of the manufacturing sector. The PMI index is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment.

Does Data Matter?

As previously noted, this week is chock full of key economic data in the United States for September. The two most important reports, the September Institute of Supply Management report on manufacturing (ISM) and the September employment report, bookend the week.

As this report was being prepared one of the many key economic reports due out this week was released. The September ISM reading was 51.6, an improvement from the August reading of 50.6, and well above the consensus estimate of 50.5. In fact, only 10 of the 82 economists surveyed by Bloomberg News expected the ISM to be above 51.5. As a reminder, a reading above 50 on the ISM report indicates that the manufacturing sector is expanding, while a reading above 42.0 indicates that the overall economy is expanding. Year to date, the ISM has averaged 56.2, consistent with GDP growth of 4.8%. All of the key components of the report (employment, new orders, production, and export orders) were also solid, suggesting further growth in the manufacturing sector in the months ahead and, importantly, no recession.

The other key report due this week is the monthly labor market report from the United States Bureau of Labor Statistics (BLS). This report is due out on Friday, October 7. Proceeding that report the market will also digest September reports on private sector employment from ADP and layoff announcements from outplacement firm Challenger, Gray and Christmas.

The BLS report is actually two reports in one. A survey of households is used to calculate the nation's unemployment rate, which stood at 9.1% in August. The consensus expects that the unemployment rate will remain at 9.1% in September. The unemployment rate is calculated by dividing the number of people who are unemployed (roughly 14 million) by the number of workers (153 million). The high unemployment rate intensifies the spotlight on the Fed, Congress and the Obama administration to enact policy and/or remove regulatory constraints to help foster a better backdrop for job creation.

While the unemployment rate data is culled from a survey of households, the monthly job count is calculated from a survey of 140,000 businesses and government agencies representing approximately 410,000 worksites throughout the United States. Recall that the private sector created just 17,000 jobs in August, below the consensus estimate of a 95,000 gain. In addition, a strike at Verizon (which has since settled) subtracted 46,000 jobs in August, meaning the August result was more like +63,000, still a deceleration from the +156,000 gain in July. The consensus for the September report is that the private sector economy created 90,000 jobs in September, with about half of the gain coming as a result of the end of the strike at Verizon. The low end of the consensus range calls for a 20,000 gain in jobs.

While the returning workers at Verizon are likely to add to the private sector job count in September, the overall payroll count (public and private sector) will again be weighed down by hiring (or lack thereof) at state and



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local governments, and more specifically, teachers. On balance, the recent data on employment—hours worked, initial claims for unemployment insurance, the employment readings of the various regional Federal Reserve surveys and the employment component of the September ISM report—continue to suggest that the labor market remains stagnant, but is not falling off a cliff as it did in 2008 and 2009. The bottom line is that the labor market is stalled out, a hostage to a great deal of economic and policy uncertainty both in the United States and overseas, leaving the labor market vulnerable to further shocks.

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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.

Stock investing involves risk including loss of principal.

An obligation rated 'AAA' has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is extremely strong.

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.

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

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