

Weekly Economic Commentary



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A November To Remember for the Economy?

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Highlights

- How is the euro-zone fiscal mess impacting the U.S. economy?
- A full slate of economic data this week may show that the U.S. economy is doing just fine, despite the turmoil in the eurozone.

Economic Calendar

Monday, November 28 New Home Sales <i>Oct</i>	Thursday, December 1 Initial Claims <i>wk 11/26</i>
Dallas Fed Manufacturing Index <i>Nov</i>	Construction Spending <i>Oct</i>
Tuesday, November 29 Consumer Confidence <i>Nov</i>	ISM Manufacturing <i>Nov</i>
Wednesday, November 30 MBA Mortgage Applications <i>wk 11/25</i>	Domestic Light Vehicle Sales <i>Nov</i>
Challenger Layoff Announcements <i>Nov</i>	Chain Store Sales <i>Nov</i>
ADP Employment Change <i>Nov</i>	Friday, December 2 Private Sector Payrolls <i>Nov</i>
Chicago Area Purchasing Managers Index <i>Nov</i>	Unemployment Rate <i>Nov</i>
Pending Home Sales <i>Oct</i>	Nonfarm Payrolls <i>Nov</i>
Beige Book	

Concerns over the eurozone dominated the month of November in the global financial markets, leading to another difficult month for equity market returns and risk assets in general, and another solid month of returns for U.S. Treasuries and other safe-haven investments. While the economic backdrop soured in the eurozone, and continued to slow in China, the U.S. economy held up reasonably well in November, and this week's batch of economic reports are likely to support that view. Monetary policy will also garner a great deal of attention this week, with a full slate of Federal Reserve (Fed) officials scheduled to speak, along with the release of the Fed's Beige Book, a qualitative assessment of economic and business conditions in each of the 12 regional Fed districts. No fewer than six global central banks meet to set rates this week; three of the six are likely to cut rates.

Throughout November and indeed over the past several months as well, financial markets have largely ignored the solid, but not spectacular, growth in the United States. Many market participants remain focused on the current and potential impact of the euro-zone crisis on the United States and global economies, and rightly so. A loss of confidence in policymakers, stresses in banking and financial markets, and higher borrowing rates are all ways in which the fiscal mess in Europe may impact the United States and other global economies. A likely recession in the eurozone (and in the United Kingdom) will slow U.S. exports to those areas. The United States sends about 15% of its exports to the eurozone and the United Kingdom. Since 20% of China's exports head to the Eurozone, China's export driven economy is likely to slow as well. While the direct impact of a recession in Europe on the global economy would certainly slow global growth, a global recession similar to the Great Recession of 2007–2009 is not a foregone conclusion, although many markets are already in the process of pricing in just such an outcome.

Easier monetary policy can offset some, but not all, of the financial market stresses and higher borrowing costs associated with the eurozone fiscal mess. Many emerging market central banks are already easing policy, and developed market central banks, including the Fed, have already begun to use nontraditional measures (such as quantitative easing) to cushion the global economy from the situation in Europe.

Our view remains that the U.S. economy is likely to grow between 2.5% and 3.0% in the fourth quarter of 2011 and post growth of around 2.0% in 2012. A further, dramatic deterioration of the fiscal and market situation in Europe, a policy mistake here in the United States or abroad, or an



exogenous event (terror attack, natural disaster, etc.), among other events, may cause us to change our view.

As we wrote in last week's *Weekly Economic Commentary*, financial markets continue to ignore the relatively solid run of economic data seen over the past several months, focusing instead on the fiscal crisis in Europe. Nevertheless, the economic data helps to drive earnings prospects in the United States, and earnings are the ultimate driver of stock prices. The economic and corporate data may not matter to market participants today, but once it starts to matter again, some market participants may be surprised by how well the U.S. economy is performing.

Will it be a November to Remember for the United States Economy?

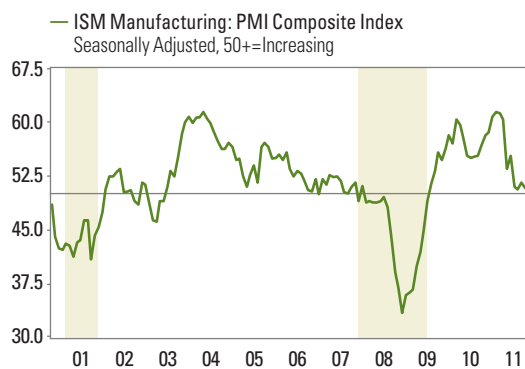
This week, the focus in the United States will be on November data, with key reports on employment, the consumer, and manufacturing. The reports on employment, which include the ADP employment report on private sector hiring in November, the Challenger report on layoff and hiring announcements in November, along with the government's November employment report, are likely to be consistent with the weekly reports on initial claims for unemployment insurance in November which revealed that the labor market was improving, albeit modestly as the month progressed. The market is looking for about a 150,000 gain in private sector employment in November, following the 104,000 increase in private sector jobs in October and an average monthly gain of 152,900 so far this year. The unemployment rate is expected to remain at 9.0% in the month.

Early reports from the retailers over the just-completed Thanksgiving weekend suggest that the consumer got off to a very good start in the holiday shopping season, confounding the experts who were looking for a more modest gain in sales this holiday shopping season (Please see this week's *Weekly Market Commentary* for details). The market will get more detail on the solid start to the 2011 holiday shopping season as retailers report their November sales (and provide guidance for December) on Thursday, December 1. The market will also digest a report on vehicle sales in November this week. Vehicle sales and production are at three-and-a-half year highs.

The manufacturing sector is also in the spotlight this week, highlighted by the Institute for Supply Management's (ISM) report on manufacturing for November. The market is looking for a slight expansion in manufacturing activity in November to 51.6 from 50.8 in October. A reading above 50 on the ISM indicates that the manufacturing sector is expanding. A reading above 42 has historically been consistent with growth in the overall economy. The ISM has been over 50 in every month since July 2009, and has been above 42 since April 2009 [Chart 1].

As previously noted, monetary policy will also be in focus this week, with the release of the Fed's Beige Book, accompanied by a full roster of Fed speakers. We continue to expect the Fed to pursue historically accommodative monetary

1 The ISM Has Been Above 50 Since July 2009, and Above 42 Since Early 2009



Source: Institute for Supply Management, Haver Analytics 11/28/11

(Shaded areas indicate recession)

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.

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.



policy in the period ahead. Even if the economy tracks to the consensus expectation (roughly 2.0% real gross domestic product growth in 2012 and 2.5% in 2013), the Fed is likely to ease even more in 2012 (via additional purchases of Treasury securities or mortgage-backed securities in the open market), as the Fed's forecasts for economic growth and the unemployment rate remain more optimistic than the consensus.

The Beige Book is once again likely to be dominated by the word "uncertain". The words (or derivations of the word) appeared 26 times in the Beige Book released in October and 33 times in the Beige Book released in early September 2011. Europe, the super committee, the economic outlook and the holiday shopping season are all likely to be mentioned in this edition of the Beige Book, which is being prepared ahead of the December 13 FOMC meeting.

There are a number of Fed officials slated to make public appearances this week, but the only member of the Fed's "center of gravity" set to speak this week is Vice Chair Janet Yellen. We continue to look to the Fed's "center of gravity" —Chairman Bernanke, Vice-Chair Yellen and New York Fed President Dudley—rather than the fringes of the Fed, for any shift in tone.

Outside of the United States, no fewer than six central banks meet this week to set policy and three of the six (Brazil, Thailand, and the Philippines) are expected to cut rates, in part to help combat the impact of the Eurozone debt debacle on their domestic economies. China's central bank, the People's Bank of China (PBOC), does not have a set meeting schedule. However, the PBOC is watching the domestic inflation data in China closely, and may choose at any time to reverse some of the restrictive monetary policy it put in place between early 2010 and mid-2011. The official Chinese ISM report (commonly referred to as the PMI) for November is due out this week, and could provide a catalyst for the PBOC to act, especially if the report shows—as expected—that manufacturing in China contracted in November 2011 for the first time since early 2009.

IMPORTANT DISCLOSURES

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The Beige Book is a commonly used name for the Fed report called the Summary of Commentary on Current Economic Conditions by Federal Reserve District. It is published just before the FOMC meeting on interest rates and is used to inform the members on changes in the economy since the last meeting.

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